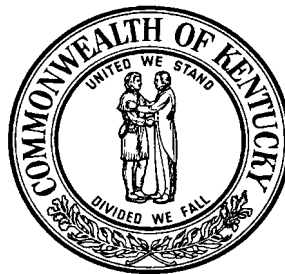


**REPORT OF THE STATEWIDE SINGLE AUDIT OF THE
COMMONWEALTH OF KENTUCKY**

VOLUME I

**For the Year Ended
June 30, 2012**



**ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS
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THE STATEWIDE SINGLE AUDIT OF THE COMMONWEALTH OF KENTUCKY
VOLUME I
FOR THE YEAR ENDED JUNE 30, 2012

Background

The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, requires an annual audit of the financial statements and compliance with requirements applicable to major federal programs. The Auditor of Public Accounts (APA) meets these requirements and submits audit findings required to be reported by auditing standards generally accepted in the United States of America, *Government Auditing Standards* and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, through our opinion on the Commonwealth's Comprehensive Annual Financial Report (CAFR) and through the Statewide Single Audit of Kentucky (SSWAK). Our SSWAK report is contained in two volumes as noted below.

SSWAK - Volume I contains financial reporting information based on our audit of the CAFR. It includes the APA's opinion on the Schedule of Expenditures of Federal Awards (SEFA) in relation to the financial statements, the *Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*, and financial statement findings related to internal control and compliance.

SSWAK - Volume II will present elements required under OMB Circular A-133, including the *Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133*, and the Schedule of Findings and Questioned Costs.

Comprehensive Annual Financial Report

The CAFR, including our report thereon based on our audit and the reports of other auditors, has been issued under separate cover. We identified in our Independent Auditor's Report on the CAFR the percentages of various funds and component units audited by other auditors. The agencies and funds audited by other auditors, as well as contact information, are presented in the Appendix of this report.

The scope of the CAFR audit included:

- An audit of the basic financial statements and combining financial statements;
- Limited procedures applied to required supplementary information;
- An audit of the SEFA sufficient to give an opinion in relation to the basic financial statements; and,
- Tests of compliance with certain provisions of laws, regulations, contracts, and grants, and tests of internal controls, where applicable.

**THE STATEWIDE SINGLE AUDIT OF THE COMMONWEALTH OF KENTUCKY
VOLUME I
FOR THE YEAR ENDED JUNE 30, 2012**

Schedule of Expenditures of Federal Awards

The SEFA presented within this report is organized by federal grantor. The Catalog of Federal Domestic Assistance (CFDA) numbers and program names are listed under the federal grantor administering the program. The state agencies expending the federal funds are listed beside each CFDA number. The notes to the SEFA provide more detailed information on certain aspects of the expenditures. Clusters of programs are indicated in the schedule by light gray shading. The identification of major federal programs and our report thereon will be presented in our report *SSWAK - Volume II*.

For fiscal year ended June 30, 2012, the total federal dollars expended by the Commonwealth of Kentucky was \$ 8,616,935,218 in cash awards and \$ 1,372,745,075 in noncash awards. For fiscal year 2012, the total federal cash expenditures as reported on the SEFA decreased in comparison with the total for fiscal year 2011.

Component Units

The reporting entity of the Commonwealth of Kentucky for the purposes of the CAFR includes various discretely presented component units, including state universities, identified in accordance with GASB No. 14 and 39. However, except for CAFR reporting, the Commonwealth has elected to exclude discretely presented component units from the statewide single audit. Thus, these discretely presented component units, including state universities, are not included in the accompanying SEFA and reports on internal control and compliance over financial reporting. These entities are still required to have audits performed in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, if applicable, based on their total federal expenditures.



ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

February 6, 2013

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Statewide Single Audit of Kentucky - Volume I for the year ended June 30, 2012. Volume I contains financial statement findings identified during our audit of the Comprehensive Annual Financial Report (CAFR), the Schedule of Expenditures of Federal Awards (SEFA), related notes, and our opinion thereon, as well as the Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.

We will subsequently report to you the required elements of the Federal government's Office of Management and Budget (OMB) Circular A-133 in Volume II of this report upon completion of our audit of the Commonwealth's major federal programs.

On behalf of the Office of Financial Audits of the Auditor of Public Accounts, I wish to thank the employees of the Commonwealth for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact Libby Carlin, Assistant Auditor of Public Accounts.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Adam H. Edelen", written over a horizontal line.

Adam H. Edelen
Auditor of Public Accounts



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LIST OF ABBREVIATIONS/ACRONYMS

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2012**

3PR	Third Party Payments
AADA	Adjusted Average Daily Attendance
ACH	Automated Clearing House
ADB	Agriculture Development Board
AFR	Annual Financial Report
AGR	Department of Agriculture
AICPA	American Institute of Certified Public Accountants
AOC	Administrative Office of the Courts
APA	Auditor of Public Accounts
ARB	Accounts Receivable Branch
ARRA	American Recovery and Reinvestment Act
BPP	Business Process Procedures
BVDA	BVDA
CA	Cost Allocation
CAFR	Comprehensive Annual Financial Report
CAMRA	Complete Asset Management Reporting and Accounting
CDC	Centers for Disease Control
CED	Cabinet for Economic Development
CFDA	Catalog of Federal Domestic Assistance
CFR	Code of Federal Regulations
CHFS	Cabinet for Health and Family Services
CIO	Chief Information Officer
CMA	Commission on Military Affairs
Commonwealth	Commonwealth of Kentucky
CORR	Department of Corrections
COT	Commonwealth Office of Technology
CPA	Certified Public Accountant
CR	Cash Receipt
CT	Contract
CT2	Contract 2-Way Match
CTT1	Contract KYTC
CTT2	Contract 2-Way Match KYTC
CW	Checkwriter
CWA	Checkwriter Accounting
CWC	Checkwriter Cancellation
DAB	Data Analysis Branch
DBHDID	Department for Behavioral Health and Developmental and Intellectual Disabilities
DBR	Daily Business Report
DCBS	Department of Community Based Services
DCJT	Department of Criminal Justice Training
DCTRL	Document Control

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)**

DDS	Division of District Support
DEI	Department of Employee Insurance
DEM	Division of Employee Management
DFDS	Division of Financial and Data Services
DGA	Division of General Accounting
DIS	Department of Income Support
DJJ	Department of Juvenile Justice
DLA	Department of Libraries and Archives
DLG	Department for Local Government
DMS	Department for Medicaid Services
DO	Delivery Order
DO2	Delivery Order 2-Way Match
DOA	Division of Accounts
DOC	Department of Corrections
DOP	Department of Parks
DTS	Division of Technology Services
DWI	Department for Workforce Investment
EBT	Electronic Benefit Transfer
EDU	Department of Education
EEC	Energy and Environment Cabinet
EFT	Electronic Funds Transfers
eMARS	enhanced Management Administrative and Reporting System
ePAY	ePayment Gateway
EPA	Environmental Protection Agency
EPSB	Education Professional Standards Board
ERQ	Event Requirements
F&W	Department of Fish and Wildlife Resources
FAC	Finance and Administration Cabinet
FDC	Future Design Consideration
FEMA	Federal Emergency Management Agency
FICA	Federal Insurance Contributions Act
FICO	Finance and Control
Finance	Finance and Administration Cabinet
FMB	Financial Management Branch
FSA	Flexible Spending Account
FSC	Forward Schedule of Changes
FTP	File Transfer Protocol
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAIP	General Accounting Intercept Payment
GASB	Governmental Accounting Standards Board

COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

GAX	General Accounting Expense/Expenditure
GHI	Group Health Insurance
GLI	Group Life Insurance
GOV	Office of the Governor
GSA	Government Services Administration
HCMP	Human Capital Management Processing
HIPPA	Health Insurance Portability and Accountability Act
HR	Human Resource
HRA	Health Reimbursement Account
HRC	Kentucky Commission on Human Rights
HRG	Human Resource Generalist
ID	Identification
IRSA	Image Services Resource Adapter
IT	Information Technology
JMX	Java Management Extensions
JUST	Justice and Public Safety Cabinet
JUV	Department of Juvenile Justice
JV2P	Parks Receivable
KAC	Kentucky Arts Council
KAR	Kentucky Administrative Regulations
KBE	Kentucky Board of Elections
KCR	KHRIS Change Request
KDE	Kentucky Department of Education
KECC	Kentucky Employees Charitable Campaign
KEHP	Kentucky Employee Health Plan
KETS	Kentucky Education Technology System
KHC	Kentucky Heritage Council
KHEAA	Kentucky Higher Education Assistance Authority
KHP	Kentucky Horse Park
KHRIS	Kentucky Human Resource Information System
KHS	Kentucky Historical Society
KIDS	Office of Knowledge, Information, and Data Services
KOC	KHRIS Oversight Committee
KOHS	Kentucky Office of Homeland Security
KRS	Kentucky Revised Statute
KRS	Kentucky Retirement System
KSP	Kentucky State Police
KST	Kentucky State Treasury
KVE	Kentucky Vehicle Enforcement
KY	Kentucky
KYMMIS	Kentucky Medicaid Management Information System

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)**

KYTC	Kentucky Transportation Cabinet
LABOR	Labor Cabinet
LIB	Life Insurance Branch
LRC	Legislative Research Commission
LWIA	Local Workforce Investment Area
MCO	Managed Care Organization
MIL	Military Affairs
MMIS	Medicaid Management Information System
MUNIS	Municipal Information System
NA	Not Applicable
NBIS	National Bridge Inspection Standards
OAG	Office of Attorney General
OB1	Management Budget
OC	Office of the Controller
OET	Office of Employment and Training
OFM	Office of Financial Management
OLS	Office of Legal Services
OMB	Office of Management and Budget
OMS	Operations Management System
OSBD	Office of the State Budget Director
PAN	Personnel Action Notification
PAR	Personnel Action Request
PARKS	Department of Parks
PC	Personnel Cabinet
PD&P	Project Delivery & Preservation
PDR	Payroll Distribution Report
PerNr	Personnel Numbers
Personnel	Personnel Cabinet
PHI	Personal Health Information
PII	Personally Identifiable Information
PO	Purchase Order
PO2	Purchase Order 2-Way Match
PON2	Proof of Necessity Agreement
Pontis	Pontis Bridge Management System
PPC	Public Protection Cabinet
PRC	Commodity Based Payment Requisition
PRCI	Commodity Based Internal Payment Requisition
PUBAD	Department of Public Advocacy
QC	Quality Control
R&D	Research and Development
REV	Department of Revenue

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)**

RFC	Request for Change
SAP	Systems Applications and Products
SAS	Statewide Accounting Services
SCR	System Change Request
SEEK	Support Education Excellence in Kentucky
SEFA	Schedule of Expenditures of Federal Awards
SFTP	Secure File Transfer Protocol
SFY	State Fiscal Year
SOS	Secretary of State
SOW	Statement of Work
SP	State Park
SR	Solicitation Response
SRP	State Resort Park
SRW	Solicitation Response Wizard
SSWAK	Statewide Single Audit of Kentucky
STY	State Tax Year
TAH	Tourism, Arts, and Heritage Cabinet
TC	Transportation Cabinet
TED	Transportation Enterprise Database
TM	Time Management
TPA	Third Party Administrator
Treasury	Kentucky State Treasury
UI	Unemployment Insurance
UNIX	Uniplexed Information and Computing System
UPS	Unified Prosecutorial System
US	United States
USDA	United States Department Of Agriculture
UITF	Unemployment Insurance Trust Fund
VA	Department of Veterans' Affairs
WBS	Work Breakdown Structure
WBSCM	Web Based Supply Chain Management
WIA	Workforce Investment Act
WORK	WIA Online Reporting of Kentucky
XML	Extensible Markup Language

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ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

Independent Auditor's Report

We have audited the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Kentucky as of and for the year ended June 30, 2012, and have issued our report thereon dated December 14, 2012. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements taken as a whole.

The schedule of expenditures of federal awards is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed and not when incurred.

In our opinion, except for the effects of the application of a different basis of accounting, as explained above, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the Commonwealth's basic financial statements taken as a whole.

This report is intended solely for the information and use of management, members of the legislature, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Adam H. Edelen", written over a horizontal line.

Adam H. Edelen
Auditor of Public Accounts

December 14, 2012



SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Agriculture					
Direct Programs:					
10.025	Plant and Animal Disease, Pest Control, and Animal Care (Note 7)	AGR	\$ 352,827	\$	\$
		F&W	65,476		
10.028	Wildlife Services (Note 15)	F&W			
10.066	Livestock Assistance Program (Note 15)	AGR			
10.069	Conservation Reserve Program (Note 15)	EEC			
10.072	Wetlands Reserve Program	EEC	20,283		
10.086	ARRA-Aquaculture Grants Program (AGP) (Note 14)(Note 15)	ADB			
10.093	Voluntary Public Access and Habitat Incentive Program	F&W	410,619		
10.103	2009 Aquaculture Grant Program (Note 15)	ADB			
10.153	Market News	AGR	8,334		
10.156	Federal-State Marketing Improvement Program	AGR	17,137		
10.163	Market Protection and Promotion	AGR	114,123		
10.169	Specialty Crop Block Grant Program	AGR	58,348		
10.170	Specialty Crop Block Grant Program-Farm Bill	AGR	262,735		
Supplemental Nutrition Assistance Program Cluster:					
10.551	Supplemental Nutrition Assistance Program (Note 2) (Note 11)	CHFS		1,294,692,187	
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (Note 2)	CHFS	45,150,008		8,730,333
10.561	ARRA-State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (Note 2) (Note 14) (Note 15)	CHFS			
Child Nutrition Cluster:					
10.553	School Breakfast Program (Note 2)	EDU	64,152,089		64,078,713
		JUV	385,971		
10.555	National School Lunch Program (Note 2) (Note 11)	EDU	168,211,822		168,074,859
		AGR		21,001,493	
		JUV	677,204		
10.556	Special Milk Program for Children (Note 2)	EDU	48,465		48,465
10.559	Summer Food Service Program for Children (Note 2)	EDU	6,132,140		6,028,635
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (Note 2)	CHFS	124,401,704		24,579,872
10.558	Child and Adult Care Food Program (Note 2)	EDU	34,942,420		34,650,005
10.560	State Administrative Expenses for Child Nutrition	EDU	2,658,572		
		AGR	486,816		
10.565	Commodity Supplemental Food Program (Note 11)(Note 12)	AGR	1,698,835	5,430,123	
Emergency Food Assistance Cluster:					
10.568	Emergency Food Assistance Program (Administrative Costs)	AGR	1,125,328		
10.568		AGR			
	ARRA-Emergency Food Assistance Program (Administrative Costs) (Note 14) (Note 15)				
10.569	Emergency Food Assistance Program (Food Commodities) (Note 11)	AGR		5,931,378	
10.572	WIC Farmers' Market Nutrition Program (FMNP)	CHFS	209,343		
		AGR			
10.574	Team Nutrition Grants (Note 15)	EDU			
10.576	Senior Farmers Market Nutrition Program	AGR	328,186		
10.578	ARRA-WIC Grants to States (WGS) (Note 14)	CHFS	886,876		
10.579	Child Nutrition Discretionary Grants Limited Availability	EDU	29,950		29,950
10.579	ARRA-Child Nutrition Discretionary Grants Limited Availability (Note 14) (Note 15)	EDU			
10.582	Fresh Fruit and Vegetable Program	EDU	2,558,128		2,558,128
10.652	Forestry Research	EEC	202,560		
10.664	Cooperative Forestry Assistance (Note 11)	EEC	2,088,211	373,658	564,274
10.676	Forest Legacy Program	EEC	3,268,191		
10.678	Forest Stewardship Program	EEC	12,004		
10.680	Forest Health Protection	EEC	63,160		19,266
10.769	Rural Business Enterprise Grants	AGR	11,014		
10.771	Rural Cooperative Development Grants (Note 15)	AGR			
10.902	Soil and Water Conservation	EEC	424,933		
		F&W	362,722		
10.912	Environmental Quality Incentives Program	EEC	60,464		
10.913	Farm and Ranch Lands Protection Program	AGR	487,708		
10.914	Wildlife Habitat Incentive Program (Note 15)	EEC			
		F&W			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Department of Agriculture (Continued)</u>					
Direct Programs (Continued):					
10.923	Emergency Watershed Protection Program	EEC			
		TC	135,168		
10.923	ARRA-Emergency Watershed Protection Program (Note 14)	EEC	10,040		
10.NA(1)	Rural Rehabilitation Student Loan Program (Note 3) (Note 15)	AGR			
10.NA(2)	Conservation Farm Bill Program	EEC	50,000		
Total U.S. Department of Agriculture			<u>\$ 462,569,914</u>	<u>\$ 1,327,428,839</u>	<u>\$ 309,362,500</u>
<u>U.S. Department of Commerce</u>					
Direct Programs:					
Public Works and Economic Development Cluster:					
11.307	Economic Adjustment Assistance	DLG	\$ 29,400	\$	\$
		MIL	39,666		
11.468	Applied Meteorological Research (Note 15)	KOHS			
11.469	Congressionally Identified Awards and Projects (Note 15)	PARKS			
11.555	Public Safety Interoperable Communications Grant Program	KSP	2,832,333		
		KOHS	680,979		647,023
11.557	ARRA-Broadband Technology Opportunities Program (BTOP) (Note 14)	DLA	880,193		827,133
11.558	ARRA-State Broadband Data and Development Grant Program (Note 14)	COT	787,133		
Total U.S. Department of Commerce			<u>\$ 5,249,704</u>	<u>\$ 0</u>	<u>\$ 1,474,156</u>
<u>U.S. Department of Defense</u>					
Direct Programs:					
12.002	Procurement Technical Assistance For Business Firms	CED	\$ 89,194	\$	
12.106	Flood Control Projects	F&W	490,909		
12.113	State Memorandum of Agreement Program for the Reimbursement of Technical Services	EEC	90,736		
12.400	Military Construction, National Guard	MIL	15,590,028		
12.401	National Guard Military Operations and Maintenance (O & M) Projects	MIL	22,335,480		
12.401	ARRA-National Guard Military Operations and Maintenance (O & M) Projects (Note 14)	MIL	2,170		
12.404	National Guard ChalleNGe Program	MIL	3,097,338		
12.607	Community Economic Adjustment Assistance for Establishment, Expansion, Realignment, or Closure of a Military Installation	CMA	284,696		27,000
12.700	Donations/Loans of Obsolete DOD Property (Note 15)	KSP			
12.NA(1)	Chemical Demilitarization and Remediation Activity for Hazardous Waste Activities at Chemical Demilitarization Facilities	EEC	488,555		49,457
12.NA(4)	Teacher and Teacher's Aide Placement Assistance Program	EPSB	80,534		
Total U.S. Department of Defense			<u>\$ 42,549,640</u>	<u>\$ 0</u>	<u>\$ 76,457</u>
<u>U.S. Department of Housing and Urban Development</u>					
Direct Programs:					
Community Development Block Grants-State-Administered Small Cities Program					
14.228	Community Development Block Grants/State's Program and Non- Entitlement Grants in Hawaii (Note 2)(Note 8)	DLG	\$ 33,406,545	\$	\$ 32,835,099
		MIL	5,221		
14.255	ARRA-Community Development Block Grants/State's program and Non-Entitlement Grants in Hawaii (Note 2)(Note 14)	DLG	1,803,371		1,749,449
14.251	Economic Development Initiative -Special Project, Neighborhood Initiative and Miscellaneous Grants	PARKS	79,654		
14.262	ARRA-Homeless Prevention and Rapid Re-Housing Program Technical Assistance (Note 14)	DLG	1,482,582		5,777
14.401	Fair Housing Assistance Program-State and Local	HRC	151,997		
14.408	Fair Housing Initiatives Program (Note 15)	HRC			
14.900	Lead-Based Paint Hazard Control in Privately-Owned Housing	CHFS	30,826		10,153
Total U.S. Department of Housing and Urban Development			<u>\$ 36,960,196</u>	<u>\$ 0</u>	<u>\$ 34,600,478</u>

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient			
			Cash	Noncash				
U.S. Department of the Interior								
Direct Programs:								
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	EEC	\$	11,384,837	\$	49,342		
15.252	Abandoned Mine Land Reclamation (AMLR) Program (Note 2)	EEC		42,021,057		13,457,367		
15.255	Science and Technology Projects Related to Coal Mining and Reclamation	EEC		130,806				
Fish and Wildlife Cluster:								
15.605	Sport Fish Restoration Program (Note 7)	F&W		4,162,239				
15.611	Wildlife Restoration and Basic Hunter Education (Note 9)	F&W		6,871,140				
15.614	Coastal Wetlands Planning, Protection and Restoration Act (Note 15)	F&W						
15.615	Cooperative Endangered Species Conservation Fund	F&W		81,405				
		EEC		51,089				
15.616	Clean Vessel Act	F&W		100,526				
15.622	Sportfishing and Boating Safety Act (Note 15)	F&W						
15.623	North American Wetlands Conservation Fund (Note 15)	EEC						
15.632	Conservation Grants Private Stewardship for Imperiled Species	F&W		26,382				
		EEC		14,531				
15.633	Landowner Incentive Program (Note 15)	F&W						
15.634	State Wildlife Grants (Note 7)	F&W		1,043,793				
15.656	ARRA-Recovery Act Funds-Habitat Enhancement, Restoration and Improvement (Note 14) (Note 15)	F&W						
15.657	Endangered Species Conservation - Recovery Implementation Funds (Note 15)	EEC						
15.808	U.S. Geological Survey_Research and Data Collection	EEC		1,264				
		COT						
15.809	National Spatial Data Infrastructure Cooperative Agreements Program (Note 15)	COT						
15.811	Gap Analysis Program	EEC		9,394				
15.904	Historic Preservation Fund Grants-In-Aid	KHC		795,074		158,476		
15.916	Outdoor Recreation_Acquisition, Development and Planning (Note 6)	DLG		450,224		450,224		
		PARKS						
Total U.S. Department of the Interior			\$	67,143,761	\$	0	\$	14,115,409
U.S. Department of Justice								
Direct Programs:								
16.003	Law Enforcement Assistance_Narcotics and Dangerous Drugs Technical Laboratory Publications (Note 15)	COT	\$		\$		\$	
16.017	Sexual Assault Services Formula Program	JUST		167,939				167,939
16.202	Prisoner Reentry Initiative Demonstration	CORR		518,537				
16.203	Promoting Evidence Integration in Sex Offender Management Discretionary Grant Program	JUV						
		CORR		15,724				
		JUST						
16.523	Juvenile Accountability Block Grants	JUV		429,355				50,558
		AOC		270				
		UPS		49,993				
		PUBAD						
16.540	Juvenile Justice and Delinquency Prevention_Allocation to States	JUV		565,915				283,816
16.543	Missing Children's Assistance	KSP		295,938				
16.548	Title V_Delinquency Prevention Program	JUV		171				
16.549	Part E-State Challenge Activities (Note 15)	JUV						
16.550	State Justice Statistics Program for Statistical Analysis Centers	JUST		16,734				
16.554	National Criminal History Improvement Program (NCHIP)	KSP		26,097				
		KOHS						
		JUST						
16.560	National Institute of Justice Research, Evaluation, and Development Project Grants	KSP		518,118				
		JUST		55,952				
16.575	Crime Victim Assistance	JUST		5,205,882				4,963,635
		UPS		318,170				
16.576	Crime Victim Compensation	PPC		533,764				
16.579	Edward Byrne Memorial Formula Grant Program (Note 15)	JUST						
		CORR						
		KSP						
		JUV						
		PUBAD						

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Department of Justice (Continued)</u>					
Direct Programs (Continued):					
16.580	Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	CHFS KSP JUST PUBAD	485,560		
16.582	Crime Victim Assistance/Discretionary Grants	JUST	17,122		8,945
16.585	Drug Court Discretionary Grant Program (Note 7)	AOC CHFS	250,290 74,469		74,469
16.586	Violent Offender Incarceration and Truth in Sentencing Incentive Grants (Note 15)	JUST			
16.588	Violence Against Women Formula Grants	JUST UPS OAG CHFS KSP	311,090 164,410 23,393		311,090
16.588	ARRA-Violence Against Women Formula Grants (Note 14)	JUST	1,651,725		1,554,188
16.589	Rural Domestic Violence, Dating Violence, Sexual Assault, and Stalking Assistance Program (Note 15)	JUST			
16.592	Local Law Enforcement Block Grants Program (Note 15)	KSP JUST			
16.593	Residential Substance Abuse Treatment for State Prisoners	CORR JUST JUV	121,426 5,388		
16.606	State Criminal Alien Assistance Program	CORR	36,991		
16.607	Bulletproof Vest Partnership Program (Note 15)	KSP CORR JUST			
16.609	Project Safe Neighborhoods	UPS KSP	9,689		
16.610	Regional Information Sharing Systems (Note 15)	COT			
16.710	Public Safety Partnership and Community Policing Grants	JUST KSP	217,841		
16.727	Enforcing Underage Drinking Laws Program	KSP	336,425		226,057
16.728	Drug Prevention Program (Note 15)	TC			
16.735	Protecting Inmates and Safeguarding Communities Discretionary Grant Program	CORR	9,472		
JAG Program Cluster:					
16.738	Edward Byrne Memorial Justice Assistance Grant Program	JUST KSP CORR AOC JUV UPS DCJT PUBAD	2,531,053 510,756 281,464 91,642 1,762 4,756 47,327		2,374,654
16.738	ARRA-Edward Byrne Memorial Justice Assistance Grant Program (Note 14)(Note 15)	CORR			
16.803	ARRA-Recovery Act-Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to States and Territories (Note 14)	KSP JUST UPS F&W AOC PUBAD JUV CHFS	125,995 1,237,824 38,692 18,343 167,636 98,863		763,749
16.804	ARRA-Recovery Act-Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to Units of Local Government (Note 14)(Note 15)	OAG DCJT			

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Justice (Continued)					
Direct Programs (Continued):					
16.740	Statewide Automated Victim Information Notification (SAVIN) Program	CORR	278,000		
16.741	DNA Backlog Reduction Program	KSP	435,335		
16.743	Forensic Casework DNA Backlog Reduction Program	PUBAD	309,274		
		JUST			
16.744	Anti-Gang Initiative (Note 15)	KSP			
16.745	Criminal and Juvenile Justice and Mental Health Collaboration Program (Note 7)	AOC	72,843		
16.746	Capital Case Litigation	JUST	3,846		
		OAG	32,010		
		PUBAD	75,494		
16.748	Convicted Offender and/or Arrestee DNA Backlog Reduction Program (Note 15)	JUST			
16.750	Support for Adam Walsh Act Implementation Grant Program	KSP	207,276		
16.800	ARRA-Recovery Act-Internet Crimes Against Children Task Force Program (ICAC) (Note 14)	KSP	242,668		
16.801	ARRA-Recovery Act-State Victim Assistance Formula Grant Program (Note 14)	JUST	72,997		72,997
16.802	ARRA-Recovery Act-State Victim Compensation Formula Grant Program (Note 14) (Note 15)	PPC			
16.808	ARRA-Recovery Act-Edward Byrne Memorial Competitive Grant Program (Note 14)	KSP	1,153,373		
		CORR			
16.810	ARRA-Recovery Act-Assistance to Rural Law Enforcement to Combat Crime and Drugs Competitive Grant Program (Note 14)	OAG	1,318,467		
		UPS	34,298		
16.812	Second Chance Act Prisoner Reentry Initiative	CORR	59,275		
16.813	NICS Act Record Improvement Program	AOC	70,269		
		KSP	73,362		
16.NA(1)	Drug Enforcement Administration	KSP	1,351,084		
16.NA(2)	Federal Bureau of Investigation	KSP	164,270		
16.NA(3)	Federal Methamphetamine Initiative (Note 15)	KSP			
16.NA(4)	Bureau of Alcohol, Tobacco, Firearms & Explosives (ATF) Program	KSP	9,919		
16.NA(5)	Prescription Drug Monitoring Program (Note 15)	CHFS			
16.NA(6)	District Fugitive Task Force	KSP	10,693		
16.NA(7)	Equitable Sharing-Asset Forfeiture	KSP	1,090,130		
Total U.S. Department of Justice			\$ 24,745,846	\$ 0	\$ 10,852,097
U.S. Department of Labor					
Direct Programs:					
17.002	Labor Force Statistics	DWI	\$ 1,144,435	\$	\$
17.005	Compensation and Working Conditions	LABOR	181,566		
Employment Services Cluster:					
17.207	Employment Service/Wagner-Peyser Funded Activities	DWI	7,848,303		3,250
17.207	ARRA-Employment Service/Wagner-Peyser Funded Activities (Note 14)	DWI	3,536		
17.801	Disabled Veterans' Outreach Program (DVOP)	DWI	946,440		
17.804	Local Veterans' Employment Representative Program	DWI	1,590,602		
17.225	Unemployment Insurance (Note 2)(Note 4)	DWI	570,842,439		
17.225	ARRA-Unemployment Insurance (Note 2)(Note 4)(Note 14)	DWI	659,902,918		
17.235	Senior Community Service Employment Program	CHFS	1,942,770		1,820,459
17.235	ARRA-Senior Community Service Employment Program (Note 14)(Note 15)	CHFS			
17.245	Trade Adjustment Assistance	DWI	10,593,549		9,227,918
Workforce Investment Act Cluster:					
17.258	WIA Adult Program (Note 2)	DWI	11,242,891		10,473,192
		EDU	86,575		
17.258	ARRA-WIA Adult Program (Note 2)(Note 14)	DWI	414,308		336,916
17.259	WIA Youth Activities (Note 2)	DWI	10,738,367		9,898,083
		EDU			
17.259	ARRA-WIA Youth Activities (Note 2)(Note 14)	DWI	251,194		195,425
		DLA	40,301		40,301
17.278	WIA Dislocated Worker Formula Grants (Note 2)	DWI	12,306,196		11,663,078
		EDU	23,280		1,774

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Labor (Continued)					
Direct Programs (Continued):					
17.260	WIA Dislocated Workers (Note 2)	DWI	3,847,616		3,531,982
		EDU	749,695		205,030
		LABOR	79,899		
17.260	ARRA-WIA Dislocated Workers (Note 2)(Note 14)	DWI	1,520,720		1,199,423
17.261	WIA Pilots, Demonstrations, and Research Projects (Note 15)	DWI			
17.267	Incentive Grants-WIA Section 503	DWI	808,885		682,743
17.268	H-1B Job Training Grants (Note 15)	DWI			
17.271	Worker Opportunity Tax Credit Program (WOTC)	DWI	303,795		
17.272	Permanent Labor Certification for Foreign Workers (Note 15)	DWI			
17.273	Temporary Labor Certification For Foreign Workers	DWI	269,772		
17.275	ARRA-Program of Competitive Grants for Worker Training and Placement in High Growth and Emerging Industry Sectors (Note 14)	DWI	1,439,951		1,345,026
17.276	ARRA-Health Care Tax Credit (HCTC) National Emergency Grants (NEGs) (Note 14)	DWI	565,809		
17.277	Workforce Investment Act (WIA) National Emergency Grants	DWI	1,330,525		1,323,459
17.503	Occupational Safety and Health_State Program	LABOR	3,529,227		154,110
17.504	Consultation Agreements (Note 15)	LABOR			
17.505	OSHA Data Initiative	LABOR	329		
17.600	Mine Health and Safety Grants	EEC	628,747		
17.603	Brookwood-Sago Grant (Note 15)	EEC			
Total U.S. Department of Labor			\$ 1,305,174,640	\$ 0	\$ 52,102,169
U.S. Department of Transportation					
Direct Programs:					
20.106	Airport Improvement Program	TC PARKS	\$ 518,995	\$	\$
Highway Planning and Construction Cluster:					
20.205	Highway Planning and Construction (Note 2)(Note 5)	TC PARKS	694,627,890		29,818,281
		KSP			
		REV	1,102		
		KHS	158,860		
20.205	ARRA-Highway Planning and Construction (Note 2) (Note 14)	TC	54,026,626		4,699,474
		KHP	22,160		
20.219	Recreational Trails Program (Note 2) (Note 6)	DLG	817,655		782,550
		PARKS	17,635		
20.218	National Motor Carrier Safety	KSP	3,761,285		178,977
		TC	248,688		
20.231	Performance and Registration Information Systems Management	TC	2,764		
20.232	Commercial Driver License Programs Improvement Grant	TC	309,189		
20.237	Commercial Vehicle Information Systems and Networks	TC	222,339		
20.238	Commercial Drivers License Information System (CDLIS) Modernization Grant	TC	255,447		
20.240	Fuel Tax Evasion-Intergovernmental Enforcement Effort	KSP	150,210		
		TC			
20.314	Railroad Development	TC	288,759		288,759
Federal Transit Cluster:					
20.500	Federal Transit_Capital Investment Grants	TC	2,728,236		2,728,236
20.507	Federal Transit_Formula Grants	TC	1,615,296		1,615,296
20.507	ARRA-Federal Transit_Formula Grants (Note 14)(Note 15)	TC			
20.505	Metropolitan Transportation Planning	TC	633,078		633,078
20.509	Formula Grants for Other Than Urbanized Areas	TC	12,387,438		11,719,939
20.509	ARRA-Formula Grants for Other Than Urbanized Areas (Note 14)(Note 15)	TC			
Transit Services Programs Cluster:					
20.513	Capital Assistance Program for Elderly Persons and Persons with Disabilities	TC	3,503,236		3,453,236
20.516	Job Access_Reverse Commute	TC	1,955,395		1,955,395
20.521	New Freedom Program	TC	1,126,858		1,126,858

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Department of Transportation (Continued)</u>					
Direct Programs (Continued):					
20.514	Public Transportation Research (Note 15)	TC			
Highway Safety Cluster:					
20.600	State and Community Highway Safety	TC	2,965,451		2,065,289
		KSP	382,209		
		OAG	159,978		
		AOC			
		DCJT	13,259		
20.601	Alcohol Impaired Driving Countermeasures Incentive Grants I	KSP	540,647		
		AOC	9,748		
		TC	703,774		
		DCJT	65,664		
20.602	Occupant Protection Incentive Grants	TC	249,024		131,615
		KSP	562,535		
20.609	Safety Belt Performance Grants	TC	332,495		
20.610	State Traffic Safety Information System Improvement Grants	KSP	66,125		
		TC	222,883		134,659
20.612	Incentive Grant Program to Increase Motorcyclist Safety	TC	49,948		
20.604	Safety Incentive Grants for Use of Seatbelts (Note 15)	KSP			
20.605	Safety Incentives to Prevent Operation of Motor Vehicles by Intoxicated Persons (Note 15)	TC			
20.700	Pipeline Safety Program Base Grants	EEC	252,405		
20.703	Interagency Hazardous Materials Public Sector Training and Planning Grants	MIL	308,859		
20.932	ARRA-Surface Transportation Discretionary Grants for Capital Investment (Note 14)	TC	14,583,751		11,236,550
Total U.S. Department of Transportation			\$ 800,847,896	\$ 0	\$ 72,568,192
<u>U.S. Department of Treasury</u>					
Direct Programs:					
21.NA(1)	Internal Revenue Service	KSP	\$ 3,729	\$	\$
21.NA(2)	Equitable Sharing-Asset Forfeiture (Note 15)	KSP			
21.NA(3)	State Small Business Credit Initiative	CED	5,120,835		
Total U.S. Department of Treasury			\$ 5,124,564	\$ 0	\$ 0
<u>U.S. Appalachian Regional Commission</u>					
Direct Programs:					
23.002	Appalachian Area Development	DLG	\$ 212,076	\$	\$ 212,076
		TAH			
23.011	Appalachian Research, Technical Assistance, and Demonstration Projects	DLG	1,042,657		882,000
		AOC	15,777		
Total U.S. Appalachian Regional Commission			\$ 1,270,510	\$ 0	\$ 1,094,076
<u>U.S. Equal Employment Opportunity Commission</u>					
Direct Programs:					
30.002	Employment Discrimination-State and Local Fair Employment Practices Agency Contracts	HRC	\$ 74,766	\$	\$
Total U.S. Equal Employment Opportunity Commission			\$ 74,766	\$ 0	\$ 0
<u>U.S. General Services Administration</u>					
Direct Programs:					
39.003	Donation of Federal Surplus Personal Property (Note 11)	FAC	\$	\$ 461,968	\$
39.011	Election Reform Payments (Note 13)	KBE	194,515		
Total U.S. General Services Administration			\$ 194,515	\$ 461,968	\$

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>National Aeronautics and Space Administration</u>					
Direct Programs:					
43.002	Aeronautics (Note 15)	COT	\$	\$	\$
Total National Aeronautics and Space Administration			\$ 0	\$ 0	\$ 0
<u>U.S. National Foundation on the Arts and the Humanities</u>					
Direct Programs:					
45.024	Promotion of the Arts_Grants to Organizations and Individuals (Note 15)	KHS	\$	\$	\$
		KAC			
45.025	Promotion of the Arts_Partnership Agreements	KAC	780,699		780,699
		KHS	30,000		
45.025	ARRA-Promotion of the Arts_Partnership Agreements (Note 14)(Note 15)	KAC			
45.161	Promotion of the Humanities_Research (Note 15)	HRC			
45.310	Grants to States	DLA	2,785,674		580,051
Total U.S. National Foundation on the Arts and Humanities			\$ 3,596,373	\$ 0	\$ 1,360,750
<u>U.S. Small Business Administration</u>					
Direct Programs:					
59.061	State Trade and Export Promotion Pilot Grant Program	CED	\$ 24,223	\$	\$
Total U.S. Small Business Administration			\$ 24,223	\$ 0	\$ 0
<u>U.S. Department of Veterans Affairs</u>					
Direct Programs:					
64.005	Grants to States for Construction of State Home Facilities	VA	\$ 2,779,175	\$	\$
64.015	Veterans State Nursing Home Care	VA	19,628,789		
64.203	State Cemetery Grants	VA	49,607		
Total U.S. Department of Veterans Affairs			\$ 22,457,571	\$ 0	\$ 0
<u>U.S. Environmental Protection Agency</u>					
Direct Programs:					
66.001	Air Pollution Control Program Support	EEC	\$ 1,442,293	\$	\$
66.032	State Indoor Radon Grants	CHFS	233,180		175,390
66.034	Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act (Note 11)	EEC	568,949	194,760	
66.040	State Clean Diesel Grant Program	EEC	221,774		221,774
66.040	ARRA-State Clean Diesel Grant Program (Note 14)	EEC	29,484		
66.418	Construction Grants for Wastewater Treatment Works	EEC	46,648		
66.419	Water Pollution Control State, Interstate, and Tribal Program Support (Note 11)	EEC	176,621	277,000	
66.432	State Public Water System Supervision (Note 15)	EEC			
66.436	Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements-Section 104(b)(3) of the Clean Water Act (Note 15)	EEC			
66.454	Water Quality Management Planning	EEC	216,896		27,275
66.454	ARRA-Water Quality Management Planning (Note 14)	EEC	16,649		
66.458	Capitalization Grants for Clean Water State Revolving Funds	EEC	377,168		
		PARKS	366,539		
66.458	ARRA-Capitalization Grants for Clean Water State Revolving Funds (Note 14)	EEC	156,783		
		KHP			
66.460	Nonpoint Source Implementation Grants	EEC	2,813,118		1,880,105
66.461	Regional Wetland Program Development Grants	EEC	276,932		130,146
66.463	Water Quality Cooperative Agreements (Note 15)	EEC			
66.467	Wastewater Operator Training Grant Program (Note 15)	EEC			
66.468	Capitalization Grants for Drinking Water State Revolving Funds	EEC	3,040,060		
66.468	ARRA-Capitalization Grants for Drinking Water State Revolving Funds (Note 14)	EEC	99,199		
66.471	State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs (Note 15)	EEC			
66.474	Water Protection Grants to the States	EEC	77,852		6,655
		COT			
66.605	Performance Partnership Grants	AGR	519,362		
		EEC	4,259,091		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Environmental Protection Agency (Continued)</u>					
Direct Programs (Continued):					
66.608	Environmental Information Exchange Network Grant Program and Related Assistance	EEC	228,350		
66.701	Toxic Substances Compliance Monitoring Cooperative Agreements	EEC	128,785		
66.707	TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	CHFS	204,513		31,565
66.708	Pollution Prevention Grants Program	EEC	85,667		56,666
66.709	Multi-Media Capacity Building Grants for States and Tribes	EEC	10,224		
66.717	Source Reduction Assistance	EEC	3,483		
66.801	Hazardous Waste Management State Program Support	EEC	1,700,874		
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	EEC	85,086		
66.804	Underground Storage Tank Prevention, Detection and Compliance Program	EEC	1,028,416		
66.805	Leaking Underground Storage Tank Trust Fund Corrective Action Program	EEC	1,368,249		
66.805	ARRA-Leaking Underground Storage Tank Trust Fund Corrective Action Program (Note 14)	EEC	1,844,427		
66.809	Superfund State and Indian Tribe Core Program-Cooperative Agreements	EEC	216,078		
66.817	State and Tribal Response Program Grants	EEC	923,895		
66.940	Environmental Policy and State Sustainability Grants (Note 15)	EEC			
66.951	Environmental Educational Grants (Note 15)	EEC			
Total U.S. Environmental Protection Agency			\$ 22,766,645	\$ 471,760	\$ 2,529,576
<u>U.S. Department of Energy</u>					
Direct Programs:					
81.039	National Energy Information Center	EEC	\$ 12,503	\$	\$
81.041	State Energy Program	EEC	479,073		198,963
81.041	ARRA-State Energy Program (Note 14)	EEC	18,012,373		10,978,127
		FAC	583,911		
		EDU			
		ADB	861,560		
		CED	2,490,269		
		DWI	81,673		
81.042	Weatherization Assistance for Low-Income Persons (Note 15)	FAC			
		CHFS			
81.042	ARRA-Weatherization Assistance for Low-Income Persons (Note 14)(Note 15)	FAC			
81.086	ARRA-Conservation Research and Development (Note 14)	EDU	5,826,989		5,783,979
81.104	Office of Environmental Waste Processing	EEC	915,480		103,004
		CHFS	675,775		339,371
81.119	State Energy Program Special Projects	EEC	54,896		47,930
81.119	ARRA-State Energy Program Special Projects (Note 14)	EEC	18,019		15,511
81.122	ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis (Note 14)	EEC	538,113		
81.127	ARRA-Energy Efficient Appliance Rebate Program (EEARP) (Note 14)(Note 15)	EEC			
81.128	ARRA-Energy Efficiency and Conservation Block Grant Program (EECBG) (Note 14)	DLG	2,157,336		2,080,813
		EEC	251,227		10,000
		PPC	531,415		
81.502	Pad+C726ucach Gaseous Diffusion Plant Environmental Monitoring and Oversight (Note 15)	CHFS			
81.NA(1)	Department of Energy (Note 15)	F&W			
81.NA(2)	Building Energy Codes-Adoption, Training and Compliance (Note 15)	PPC			
81.NA(2)	ARRA-Building Energy Codes-Adoption, Training and Compliance (Note 14)	EEC	139,705		
Total U.S. Department of Energy			\$ 33,630,317	\$ 0	\$ 19,557,698
<u>U.S. Department of Education</u>					
Direct Programs:					
Title I, Part A Cluster:					
84.010	Title I Grants to Local Educational Agencies (Note 2)	EDU	\$ 228,795,283	\$	\$ 227,123,543
84.389	ARRA-Title I Grants to Local Educational Agencies, Recovery Act (Note 14) (Note 2)	EDU	21,784,689		21,784,689

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Education (Continued)					
Direct Programs (Continued):					
84.011	Migrant Education_State Grant Program	EDU	7,537,163		7,398,606
84.013	Title I State Agency Program for Neglected and Delinquent Children and Youth	JUV	775,450		644,891
		CORR	52,578		
		EDU	7,857		
Special Education Cluster:					
84.027	Special Education_Grants to States (Note 2)	EDU	150,668,570		148,852,315
84.173	Special Education_Preschool Grants (Note 2)	EDU	9,293,177		8,962,775
84.391	ARRA-Special Education Grants to States, Recovery Act (Note 2)(Note 14)	EDU	18,691,684		18,675,704
84.392	ARRA-Special Education-Preschool Grants, Recovery Act (Note 2)(Note 14)	EDU	1,965,091		1,963,006
84.048	Career and Technical Education -- Basic Grants to States	DWI	9,677,550		7,245,370
		EDU	8,098,120		7,601,984
		EPSB	168,112		
		CORR	135,373		
Vocational Rehabilitation Services Cluster:					
84.126	Rehabilitation Services-_Vocational Rehabilitation Grants to States (Note 2)	DWI	46,122,188		1,708,418
84.390	ARRA-Rehabilitation Services-Vocational Rehabilitation Grants to States, Recovery Act (Note 2)(Note 14)	DWI	463,606		2,987
84.128	Rehabilitation Services_Service Projects	DWI	180,163		178,577
84.144	Migrant Education_Coordination Program	EDU	32,592		32,475
84.161	Rehabilitation Services_Client Assistance Program	DWI	141,520		
84.169	Independent Living_State Grants	DWI	322,556		312,390
84.177	Rehabilitation Services_Independent Living Services for Older Individuals Who are Blind	DWI	506,141		
84.181	Special Education-Grants for Infants and Families	CHFS	3,851,344		
84.181	ARRA-Special Education-Grants for Infants and Families (Note 14)(Note 15)	CHFS			
84.393	ARRA-Special Education-Grants for Infants and Families, Recovery Act (Note 14)	CHFS	1,672,276		82,855
84.186	Safe and Drug-Free Schools and Communities_State Grants	EDU	471,179		463,840
		JUST			
		CHFS	1,928		1,928
84.187	Supported Employment Services for Individuals with the Most Significant Disabilities	DWI	201,177		
84.196	Education for Homeless Children and Youth	EDU	1,018,359		986,627
84.213	Even Start_State Educational Agencies	EDU	666,875		637,187
84.215	Fund for the Improvement of Education (Note 10)	KHS	170,158		
		EDU			
84.224	Assistive Technology	DWI	444,429		300,121
84.240	Program of Protection and Advocacy of Individual Rights	PUBAD	203,164		
84.243	Tech-Prep Education	DWI	78,560		
		EDU	207,519		207,519
84.265	Rehabilitation Training_State Vocational Rehabilitation Unit In-Service Training	DWI	243,422		15,775
84.287	Twenty-First Century Community Learning Centers	EDU	15,945,212		15,945,212
84.298	State Grants for Innovative Programs (Note 15)	EDU			
Educational Technology State Grants Cluster:					
84.318	Educational Technology State Grants	EDU	2,033,213		2,017,982
84.386	ARRA-Education Technology State Grants, Recovery Act (Note 14)	EDU	3,150,654		2,974,961
84.323	Special Education-State Personnel Development	EDU	1,203,555		1,198,906
84.326	Special Education_Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	EDU	175,791		175,791
84.330	Advanced Placement Program (Advanced Placement Test Fee; Advanced Placement Incentive Program Grants)	EDU	1,055,983		585,789
84.331	Grants to States for Workplace and Community Transition Training for Incarcerated Individuals	CORR	319,165		
84.336	Teacher Quality Partnership Grants (Note 15)	EPSB			
84.343	Assistive Technology_State Grants for Protection and Advocacy	PUBAD	31,486		
84.350	Transition to Teaching (Note 15)	EDU			
84.357	Reading First State Grants (Note 15)	EDU			
84.358	Rural Education	EDU	5,800,792		5,770,985
84.365	English Language Acquisition State Grants	EDU	3,115,531		2,917,675

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Department of Education (Continued)</u>					
Direct Programs (Continued):					
84.366	Mathematics and Science Partnerships	EDU	2,226,400		2,155,523
84.367	Improving Teacher Quality State Grants (Note 2)	EDU	36,914,121		36,193,015
84.369	Grants for State Assessments and Related Activities	EDU	4,030,201		
84.371	Striving Readers	EDU	559,863		475,279
84.372	Statewide Data Systems	EDU	1,186,630		
School Improvement Grants Cluster:					
84.377	School Improvement Grants	EDU	6,933,511		6,748,639
84.388	ARRA-School Improvement Grants, Recovery Act (Note 14)	EDU	11,542,822		11,542,822
84.387	ARRA-Education for Homeless Children and Youth, Recovery Act (Note 14)	EDU	305,318		305,318
State Fiscal Stabilization Fund Cluster:					
84.394	ARRA-State Fiscal Stabilization Fund (SFSF) - Education State Grants, Recovery Act (Note 14)(Note 15)	GOV EDU			
84.397	ARRA-State Fiscal Stabilization Fund (SFSF) - Government Services, Recovery Act (Note 14)	CORR KSP FAC	62,313		
84.398	ARRA-Independent Living State Grants, Recovery Act (Note 14)	DWI	62,611		28,113
84.399	ARRA-Independent Living Services for Older Individuals Who Are Blind, Recovery Act (Note 14)	DWI	32,451		
84.410	Education Jobs Fund (Note 2)	EDU	76,140,842		76,001,893
84.413	Race to the Top	EDU	2,229,479		
Passed Through From the Powell County Board of Education:					
84.215	Fund for the Improvement of Education Pass Through Grantor - Various (Note 10)(Note 15)	KHS			
Passed Through From the Letcher County Board of Education:					
84.215	Fund for the Improvement of Education Pass Through Grantor - Various (Note 10) (Note 15)	KHS			
Passed Through From the Civic Education Center:					
84.304	Civic Education- We the People and the Cooperative Education Exchange Program Pass Through Grantor - Various (Note 10)	AOC	410		
Passed Through From the Center for Civic Education:					
84.929	We the People Pass Through Grantor - Various (Note 10)(Note 15)	AOC			
Total U.S. Department of Education			\$ 689,708,207	\$ 0	\$ 620,221,485
<u>U.S. National Archives and Records Administration</u>					
Direct Programs:					
89.003	National Historical Publications and Records Grants	DLA	\$ 8,786	\$	\$
Total U.S. National Archives and Records Administration			\$ 8,786	\$ 0	\$ 0
<u>U.S. Election Assistance Commission</u>					
Direct Programs:					
90.401	Help America Vote Act Requirements Payments	KBE	\$ 128,380	\$	\$ 126,844
90.402	Help America Vote Mock Election Program (Note 15)	SOS			
Total U.S. Election Assistance Commission			\$ 128,380	\$ 0	\$ 126,844
<u>U.S. Department of Health and Human Services</u>					
Direct Programs:					
93.003	Public Health and Social Services Emergency Fund (Note 15)	CHFS	\$	\$	\$
93.041	Special Programs for the Aging_ Title VII, Chapter 3_Programs for Prevention of Elder Abuse, Neglect, and Exploitation	CHFS	67,585		65,732

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.042	Special Programs for the Aging_Title VII, Chapter 2_Long Term Care Ombudsman Services for Older Individuals	CHFS	238,588		140,615
93.043	Special Programs for the Aging_Title III, Part D_Disease Prevention and Health Promotion Services	CHFS	229,485		202,538
Aging Cluster:					
93.044	Special Programs for the Aging_Title III, Part B_Grants for Supportive Services and Senior Centers	CHFS	5,316,628		4,860,358
93.045	Special Programs for the Aging_Title III, Part C_Nutrition Services	CHFS	8,373,606		7,430,699
93.053	Nutrition Services Incentive Program	CHFS	2,083,433		1,809,408
93.705	ARRA-Aging Home-Delivered Nutrition Services for States (Note 14) (Note 15)	CHFS			
93.707	ARRA-Aging Congregate Nutrition Services for States (Note 14) (Note 15)	CHFS			
93.048	Special Programs for the Aging_Title IV_ and Title II_Discretionary Projects	CHFS	185,246		170,576
93.051	Alzheimer's Disease Demonstration Grants to States	CHFS	38,773		23,139
93.052	National Family Caregiver Support, Title III, Part E	CHFS	2,065,262		1,749,062
93.069	Public Health Emergency Preparedness (Note 11)	CHFS	8,881,928	40,496	6,760,311
93.070	Environmental Public Health and Emergency Response	CHFS	733,637		482,996
		EEC	41,542		38,542
93.071	Medicare Enrollment Assistance Program (Note 15)	CHFS			
93.087	Enhance the Safety of Children Affected by Substance Abuse	CHFS	441,626		215,377
93.089	Emergency System for Advance Registration of Volunteer Health Professionals (Note 15)	CHFS			
93.092	Affordable Care Act (ACA) Personal Responsibility Education Program	CHFS	472,085		433,901
93.103	Food and Drug Administration_Research	CHFS	1,752		
93.104	Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED)	CHFS	2,370,324		1,736,890
93.110	Maternal and Child Health Federal Consolidated Programs	CHFS	624,336		148,314
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs (Note 11)	CHFS	736,717	92,846	440,572
93.130	Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	CHFS	122,108		12,216
93.134	Grants to Increase Organ Donations (Note 15)	CHFS			
93.136	Injury Prevention and Control Research and State and Community Based Programs	CHFS	673,729		673,729
93.138	Protection and Advocacy for Individuals with Mental Illness	PUBAD	578,461		
93.150	Projects for Assistance In Transition from Homelessness (PATH)	CHFS	474,000		466,773
93.197	Childhood Lead Poisoning Prevention Projects_State and Local Childhood Lead Poisoning Prevention and Surveillance of Blood Lead Levels in Children	CHFS	81,475		62,412
93.217	Family Planning_Services	CHFS	6,173,359		5,493,132
93.230	Consolidated Knowledge Development and Application (KD&A) Program (Note 15)	CHFS			
93.234	Traumatic Brain Injury State Demonstration Grant Program (Note 15)	CHFS			
93.235	Affordable Care Act (ACA) Abstinence Education Program	CHFS	917,802		884,343
93.236	Grants to States to Support Oral Health Workforce Activities	CHFS	130,875		113,307
93.242	Mental Health Research Grants (Note 15)	CHFS			
93.243	Substance Abuse and Mental Health Services_Projects of Regional and National Significance (Note 7)	CHFS	966,295		901,237
		AOC	1,745,834		
		JUV			
		JUST			
93.251	Universal Newborn Hearing Screening	CHFS	271,384		
93.262	Occupational Safety and Health Program (Note 15)	CHFS			
93.267	State Grants for Protection and Advocacy Services	PUBAD	46,605		
Immunization Cluster:					
93.268	Immunization Cooperative Agreements (Note 11) (Note 2)	CHFS	3,125,482	43,923,126	1,649,024
93.712	ARRA-Immunization (Note 14) (Note 2)	CHFS	283,360		
93.270	Adult Viral Hepatitis Prevention and Control	CHFS	109,804		
93.276	Drug-Free Communities Support Program Grants (Note 15)	KVE			
93.283	The Affordable Care Act: Centers for Disease Control and Prevention_Investigations and Technical Assistance	CHFS	5,761,759		4,662,219
93.296	State Partnership Grant Program to Improve Minority Health	CHFS	142,495		35,800
93.414	ARRA-State Primary Care Offices (Note 14)	CHFS	69,806		
93.505	Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	CHFS	1,183,905		1,075,345

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.506	ACA Nationwide Program for National and State Background Checks for Direct Patient Access Employees of Long Term Care Facilities and Providers	CHFS	134,165		
93.507	PPHF 2012 National Public Health Improvement Initiative	CHFS	230,904		80,659
93.511	Affordable Care Act (ACA) Grants to States for Health Insurance Premium Review	PPC	446,160		
93.518	Affordable Care Act - Medicare Improvements for Patients and Providers	CHFS	581,485		473,265
93.519	Affordable Care Act (ACA) - Consumer Assistance Program Grants	PPC	15,659		
93.521	The Affordable Care Act: Building Epidemiology, Laboratory, and Health Information Systems Capacity in the Epidemiology and Laboratory Capacity for Infectious Disease (ELC) and Emerging Infections Program (EIP) Cooperative Agreements; PPHF	CHFS	652,751		129,420
93.525	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges	CHFS	5,338,618		
93.544	The Patient Protection and Affordable Care Act of 2010 (Affordable Care Act) authorizes Coordinated Chronic Diseases Prevention and Health Promotion Program	CHFS	129,702		55,094
93.556	Promoting Safe and Stable Families	CHFS	6,851,800		6,524,109
Temporary Assistance for Needy Families Cluster:					
93.558	Temporary Assistance for Needy Families (Note 2)	CHFS	176,445,383		14,765,991
93.714	ARRA-Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program (Note 2)(Note 14)(Note 15)	DWI CHFS			
93.563	Child Support Enforcement (Note 2)	CHFS AOC OAG	38,730,167 23,582		19,218,796
93.563	ARRA-Child Support Enforcement (Note 2)(Note 14)(Note 15)	CHFS			
93.564	Child Support Enforcement Research	CHFS	28,593		
93.568	Low-Income Home Energy Assistance (Note 2)	CHFS	48,276,556		48,171,561
Community Services Block Grant Cluster:					
93.569	Community Services Block Grant	CHFS	11,474,815		11,281,207
93.710	ARRA-Community Services Block Grant (Note 14)(Note 15)	CHFS			
93.571	Community Services Block Grant Formula and Discretionary Awards Community Food and Nutrition Programs (Note 15)	CHFS			
Child Care and Development Block Grant Cluster:					
93.575	Child Care and Development Block Grant (Note 2)	CHFS	43,757,813		4,944,470
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund (Note 2)	CHFS	48,750,401		8,896,060
93.585	Empowerment Zones Program (Note 15)	OC			
93.586	State Court Improvement Program (Note 7)	AOC	833,458		
93.590	Community-Based Child Abuse Prevention Grants	CHFS	2,441,139		2,208,154
93.597	Grants to States for Access and Visitation Programs	CHFS	130,003		129,375
93.599	Chafee Education and Training Vouchers Program (ETV)	CHFS	693,900		
Head Start Cluster:					
93.600	Head Start	EDU GOV	1,721 160,096		1,599 20,000
93.708	ARRA-Head Start (Note 14)	DWI EDU GOV	56,010 265,473 489,984		49,000 247,996
93.603	Adoption Incentive Payments	CHFS	910,558		
93.617	Voting Access for Individuals with Disabilities_Grants To States	KBE	139,362		139,362
93.618	Voting Access for Individuals with Disabilities-Grants for Protection and Advocacy Systems	PUBAD	74,767		
93.630	Developmental Disabilities Basic Support and Advocacy Grants	CHFS PUBAD	1,029,710 585,256		170,570
93.643	Children's Justice Grants to States	CHFS AOC OAG	125,258 60,000 50,451		12,531
93.645	Stephanie Tubbs Jones Child Welfare Services Program	CHFS	4,459,282		
93.647	Social Services Research and Demonstration (Note 15)	CHFS			
93.652	Adoption Opportunities	CHFS	353,585		350,386
93.658	Foster Care_Title IV-E (Note 2)	CHFS JUV AOC	38,732,613 2,195,500 313,339		2,649,612

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.658	ARRA-Foster Care_Title IV-E (Note 2)(Note 14)(Note 15)	CHFS			
93.659	Adoption Assistance (Note 2)	CHFS	42,693,046		
93.659	ARRA-Adoption Assistance (Note 2)(Note 14)	CHFS	128,899		
93.667	Social Services Block Grant	CHFS	20,158,379		41,617
		JUV	7,244,589		
		FAC			
93.667	ARRA-Social Services Block Grant (Note 14)(Note 15)	CHFS			
93.669	Child Abuse and Neglect State Grants	CHFS	397,961		286,789
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters_Grants to State and Indian Tribes	CHFS	1,633,542		1,624,594
93.674	Chafee Foster Care Independence Program	CHFS	2,028,721		1,199,616
93.713	ARRA-Child Care and Development Block Grant (Note 14)(Note 15)	CHFS			
93.717	ARRA-Preventing Healthcare-Associated Infections (Note 14)	CHFS	276,125		70,191
93.719	ARRA- State Grants to Promote Health Information Technology (Note 14)	CHFS	2,404,580		
Medicaid Cluster:					
93.720	ARRA-Survey and Certification Ambulatory Surgical Center Healthcare-Associated Infection (ASC-HAI) Prevention Initiative (Note 2)(Note 14)	CHFS	10,723		
93.775	State Medicaid Fraud Control Units (Note 2)	OAG	1,686,075		
93.777	State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare (Note 2)	CHFS	7,537,713		
93.778	Medical Assistance Program (Note 2)	CHFS	4,129,717,245		2,919,842
93.778	ARRA-Medical Assistance Program (Note 2)(Note 14)	CHFS	45,089,393		
93.723	ARRA-Prevention and Wellness-State, Territories and Pacific Islands(Note 14)	CHFS	812,265		624,606
93.725	ARRA-Communities Putting Prevention to Work: Chronic Disease Self-Management Program (Note 14)	CHFS	378,190		293,319
93.767	Children's Health Insurance Program (Note 2)	CHFS	143,463,984		153,535
93.779	Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	CHFS	9,444,663		1,048,740
93.780	Grants to States for Operation of Qualified High-Risk Pools	PPC	1,581,283		540,750
93.793	Medicaid Transformation Grants (Note 15)	CHFS			
93.889	National Bioterrorism Hospital Preparedness Program	CHFS	4,786,984		4,021,780
		MIL	121,775		
93.912	Rural Health Care Services Outreach, Rural Health Network Development and Small Health Care Provider Quality Improvement Program	DWI	2,657		
93.917	HIV Care Formula Grants	CHFS	9,228,569		9,019,713
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	EDU	399,479		29,659
		CHFS	185,558		4,731
93.940	HIV Prevention Activities_Health Department Based	CHFS	1,824,963		1,426,773
93.941	HIV Demonstration, Research, Public and Professional Education Projects	CHFS	466		
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	CHFS	366,013		220,800
93.945	Assistance Programs for Chronic Disease Prevention and Control (Note 15)	CHFS			
93.958	Block Grants for Community Mental Health Services	CHFS	5,024,903		4,532,717
		DWI	75,000		
		CORR	47,314		
93.959	Block Grants for Prevention and Treatment of Substance Abuse	CHFS	20,916,909		20,443,637
		KSP			
		JUST			
93.975	National All Schedules Prescription Electronic Reporting Grant (Note 15)	CHFS			
93.977	Preventive Health Services_Sexually Transmitted Diseases Control Grants (Note 11)	CHFS	1,091,694	326,040	211,780
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems (Note 15)	CHFS			
93.991	Preventive Health and Health Services Block Grant	CHFS	1,316,765		771,694
93.994	Maternal and Child Health Services Block Grant to the States	CHFS	9,120,353		5,911,059
93.NA(1)	Other Federal Assistance	CHFS	250,544		
Total U.S. Department of Health and Human Services			\$ 4,963,178,432	\$ 44,382,508	\$ 218,655,726
U.S. Corporation for National and Community Service					
Direct Programs:					
94.003	State Commissions	CHFS	\$ 203,478	\$	\$
94.004	Learn and Serve America School and Community Based Programs	EDU	39,839		39,100
		CORR			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Corporation for National and Community Service (Continued)					
Direct Programs (Continued):					
94.006	AmeriCorps	CHFS	4,009,975		4,008,109
94.006	ARRA-AmeriCorps (Note 14)(Note 15)	CHFS			
94.007	Program Development and Innovation Grants	CHFS	84,749		
94.009	Training and Technical Assistance	CHFS	56,167		
Foster Grandparents/Senior Companion Cluster:					
94.011	Foster Grandparent Program	CHFS	546,353		33,333
94.NA(1)	Clinical Laboratory Improvement Act (Note 15)	CHFS			
Total U.S. Corporation for National and Community Service			\$ 4,940,561	\$ 0	\$ 4,080,542
U.S. Office of National Drug Control Policy					
Direct Program:					
95.001	High Intensity Drug Trafficking Areas Program	KSP	\$ 1,108,723	\$	\$
Total U.S. Office of National Drug Control Policy			\$ 1,108,723	\$ 0	\$ 0
U.S. Social Security Administration					
Direct Programs:					
Disability Insurance/Supplemental Security Income Cluster:					
96.001	Social Security_Disability Insurance (Note 2)	CHFS OAG	\$ 43,842,826 94,491	\$	\$
96.009	Social Security State Grants for Work Incentives Assistance to Disabled Beneficiaries	PUBAD	149,419		
Total U.S. Social Security Administration			\$ 44,086,736	\$ 0	\$ 0
U. S. Department of Homeland Security					
Direct Programs:					
97.001	Pilot Demonstration or Earmarked Projects (Note 15)	KOHS	\$	\$	\$
97.004	Homeland Security Grant Program (Note 15)	KOHS DCJT MIL KSP			
97.012	Boating Safety Financial Assistance	F&W	1,314,445		
97.017	Pre-Disaster Mitigation (PDM) Competitive Grants	MIL	62,543		62,543
97.023	Community Assistance Program State Support Services Element (CAP-SSSE)				
97.029	Flood Mitigation Assistance	EEC MIL TC	179,464 146,559		145,056
97.032	Crisis Counseling	MIL	102,030		
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters) (Note 2)	MIL TC PARKS	30,177,108 3,900,839		23,844,447
97.039	Hazardous Mitigation Grant	KSP MIL AOC	1,278,730 5,367,424 949		5,099,472
97.040	Chemical Stockpile Emergency Preparedness Program	MIL CHFS	13,591,823		11,640,915
97.041	National Dam Safety Program	EEC	98,921		
97.042	Emergency Management Performance Grants	MIL	5,489,249		2,890,398
97.045	Cooperating Technical Partners	EEC	5,007,377		
97.047	Pre Disaster Mitigation	MIL	1,543,613		1,250,620
97.052	Emergency Operations Center	KOHS	448,733		423,237
97.055	Interoperable Emergency Communications	KOHS	445,301		430,582
97.056	Port Security Grant Program	F&W KSP	347,119 35,685		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U. S. Department of Homeland Security (Continued)</u>					
Direct Programs (Continued):					
97.067	Homeland Security Grant Program	KOHS	8,358,645		7,374,711
		DCJT			
		TC			
		F&W			
		KSP			
		MIL			
		KVE			
		COT			
		AGR			
		JUST			
		PPC	16,149		
97.070	Map Modernization Management Support (Note 15)	EEC			
97.076	National Center for Missing and Exploited Children (NCMEC) (Note 15)	KSP			
97.077	Homeland Security Research Testing, Evaluation, and Demonstration of Technologies Related to Nuclear Detection (Note 15)	TC			
97.078	Buffer Zone Protection Program (BZPP)	KOHS	209,547		203,730
		F&W			
		KSP	300,657		
		TC	155,105		
97.082	Earthquake Consortium	MIL	50,127		
97.089	Driver's License Security Grant Program	TC	641,781		
97.107	National Incident Management System (NIMS)	MIL	24,002		
97.110	Severe Repetitive Loss Program	MIL	23,993		23,993
97.116	ARRA-Port Security Grant Program (Note 14)	KSP	35,132		
Total U.S. Department of Homeland Security			\$ 79,353,050	\$ 0	\$ 53,389,704
<u>Other Federal Assistance</u>					
Direct Programs:					
NA(1)	Tennessee Valley Authority	F&W	\$ 41,262	\$	\$
NA(2)	State Justice Institute (Note 15)	AOC			
Total Other Federal Assistance			\$ 41,262	\$ 0	\$ 0
Total All State Agencies			\$ 8,616,935,218	\$ 1,372,745,075	\$ 1,416,167,859

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities and other discretely presented component units from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last two pay periods of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Noncash assistance programs are not reported in the basic financial statements of the Commonwealth for FY 2012. The noncash expenditures presented on this schedule represent the noncash assistance expended using the method or basis of valuation described in Note 11.

Clusters of programs are indicated in the schedule by light gray shading.

Programs that do not have CFDA numbers are identified using the two-digit federal identifier prefix, and the letters “NA” to denote that no specific number is applicable. Each program is numbered in parentheses, following the NA for each federal grantor.

The state agencies’ schedule is presented on the cash, modified cash, or accrual basis of accounting.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

- (a) Federal funds may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities and discretely presented component units as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities and discretely presented component units report those amounts as expenditures.

- (b) Federal funds received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$29,969,041 for FY 2012. The Commonwealth had the following programs (cash and noncash) that met the Type A program definition for FY 2012, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. These Type A programs and clusters were:

CFDA	Program Title	Expenditures
Supplemental Nutrition Assistance Program Cluster:		
10.551	Supplemental Nutrition Assistance Program	\$ 1,294,692,187
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	45,150,008
Child Nutrition Cluster:		
10.553	School Breakfast Program	64,538,060
10.555	National School Lunch Program	189,890,519
10.556	Special Milk Program for Children	48,465
10.559	Summer Food Service Program for Children	6,132,140
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	124,401,704

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 2 - Type A Programs (Continued)

CFDA	Program Title	Expenditures
10.558	Child and Adult Care Food Program	34,942,420
Community Development Block Grant-State-Administered Small Cities Program Cluster:		
14.228	Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	33,411,766
14.255	ARRA-Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	1,803,371
15.252	Abandoned Mine Land Reclamation (AMLR) Program	42,021,057
17.225	Unemployment Insurance	570,842,439
17.225	ARRA-Unemployment Insurance	659,902,918
Workforce Investment Act Cluster:		
17.258	WIA Adult Program	11,329,466
17.258	ARRA-WIA Adult Program	414,308
17.259	WIA Youth Activities	10,738,367
17.259	ARRA-WIA Youth Activities	291,495
17.278	WIA Dislocated Worker Formula Grants	12,329,476
Highway Planning and Construction Cluster:		
20.205	Highway Planning and Construction	694,787,852
20.205	ARRA-Highway Planning and Construction	54,048,786
20.219	Recreational Trails Program	835,290
Title I, Part A Cluster:		
84.010	Title I Grants to Local Educational Agencies	228,795,283
84.389	ARRA-Title I Grants to Local Educational Agencies, Recovery Act	21,784,689
Special Education Cluster:		
84.027	Special Education Grants to States	150,668,570
84.173	Special Education Preschool Grants	9,293,177
84.391	ARRA-Special Education Grants to States, Recovery Act	18,691,684
84.392	ARRA-Special Education - Preschool Grants, Recovery Act	1,965,091

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 2 - Type A Programs (Continued)

CFDA	Program Title	Expenditures
Vocational Rehabilitation Services Cluster:		
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States	46,122,188
84.390	ARRA-Rehabilitation Services - Vocational Rehabilitation Grants to States, Recovery Act	463,606
84.367	Improving Teacher Quality State Grants	36,914,121
84.410	Education Jobs Fund	76,140,842
93.563	Child Support Enforcement	38,753,749
93.568	Low-Income Home Energy Assistance	48,276,556
Immunization Cluster:		
93.268	Immunization Cooperative Agreements	47,048,608
93.712	ARRA-Immunization	283,360
Temporary Assistance for Needy Families Cluster:		
93.558	Temporary Assistance for Needy Families	176,445,383
Child Care Cluster:		
93.575	Child Care and Development Block Grant	43,757,813
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	48,750,401
93.658	Foster Care -Title IV-E	41,241,452
93.659	Adoption Assistance	42,693,046
93.767	Children's Health Insurance Program	143,463,984
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters)	35,356,677
Medicaid Cluster:		
93.720	ARRA-Survey and Certification Ambulatory Surgical Center Healthcare-Associated Infection (ASC-HAI) Prevention Initiative	10,723
93.775	State Medicaid Fraud Control Units	1,686,075
93.777	State Survey and Certification of Health Care Providers and Suppliers (Title XVIII)	7,537,713
93.778	Medical Assistance Program	4,129,717,245
93.778	ARRA-Medical Assistance Program	45,089,393

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 2 - Type A Programs (Continued)

CFDA	Program Title	Expenditures
Disability Insurance/Supplemental Security Income Cluster:		
96.001	Social Security Disability Insurance	43,937,317
Total Type A Programs		\$ 9,337,440,840

Note 3 - Federally Assisted Loan Program CFDA 10.NA(1)

The Kentucky Rural Rehabilitation Student Loan Program was initially awarded \$672,629 in 1970 by the U. S. Farmers Home Administration. Since 1970, the program has operated on interest from student loans outstanding and on income from investments administered by the Office of Financial Management. The Department of Agriculture is no longer in the business of making student loans and reassigned all loans in payment compliance to the Kentucky Higher Education Assistance Authority (KHEAA). The Department of Agriculture retained only those loans that had a delinquent payment history. This program is currently in phase-out status, with authorization from the U. S. Department of Agriculture (USDA) to eliminate the principal through issuance of specific grants and scholarships. Most outstanding loans have been classified as contingent uncollectible liabilities; however, if loan payments are received, they are directly deposited into the principal account. The total amount of money in the investment account as of June 30, 2012 was \$1,294. Student loans and investment earned interest of \$1,295. Outstanding student loans totaled \$64,466. There were no new grants or scholarships authorized by the USDA in FY12.

Note 4 - Unemployment Insurance (CFDA 17.225)

The Commonwealth paid out \$1,188,174,287 in benefits in FY 2012. The amounts shown on the accompanying schedule reflect both the amount expended for benefits from the Trust Fund and an additional \$42,571,070 of federal funds expended for administration of the program, resulting in a combined total of \$1,230,745,357 in federal expenditures. Included in this amount is \$659,778,702 in benefit payments funded by the American Recovery and Reinvestment ACT (ARRA).

Note 5 - Highway Planning and Construction (CFDA 20.205)

The information reported for this 20.205 Highway Planning and Construction program represents the activity of all open projects during FY 2012. These projects were funded from several apportionments. Apportionments refer to a federal, statutorily prescribed division or assignment of funds. The expenditures reflected on the schedule include expenditures for advance construction projects, which are not yet under agreements with the Federal Highway Administration.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 5 - Highway Planning and Construction (Continued)

Program Income - The Highway Planning and Construction Program earned program income of \$19,290,606 in FY 2012. This income is comprised of program income (interest) attributable to the Garvee Bonds and is shown as other additions.

Refunds - Expenditures for the Highway Planning and Construction Program were shown net of any refunds, resulting from a reimbursement of prior or current year expenditures. Refunds totaled \$1,913,368 for FY 2012.

Note 6 - Outdoor Recreation - Acquisition, Development and Planning (CFDA 15.916) and Recreational Trails Program (CFDA 20.219)

Administrative costs are shown as expended when received from the federal government. These costs are recovered through a negotiated, fixed indirect cost rate. Any over or under recovery will be recouped in the future.

Note 7 - Research and Development Expenditures

OMB Circular A-133 Section 105 states, "Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-federal entity."

The expenditures presented in the SEFA include R&D expenditures. The R&D portion of the expenditures for each program is listed below.

CFDA	Program Title	State Agency	Expenditures
10.025	Plant and Animal Disease, Pest Control, and Animal Care	F&W	\$ 42,419
15.605	Sport Fish Restoration Program	F&W	532,264
15.634	State Wildlife Grants	F&W	951,669
16.585	Drug Court Discretionary Grant Program	AOC	14,125
16.745	Criminal and Juvenile Justice and Mental Health Collaboration Program	AOC	46,588
93.243	Substance Abuse and Mental Health Services-Projects of Regional and National Significance	AOC	359,555
93.586	State Court Improvement Program	AOC	58,419
			<u>\$ 2,005,039</u>

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 8 - Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii (CFDA 14.228)

The Commonwealth matches the federal portion of administration dollar for dollar. Cash expenditures include the federal portion of administration.

Note 9 - Wildlife Restoration and Basic Hunter Education (CFDA 15.611)

The Department of Fish and Wildlife Resources leases properties from the U.S. Army Corp of Engineers for Condition Three and Condition Five Projects. These projects stipulate that the properties leased be managed for wildlife purposes and may produce income. The leases for wildlife management rights on these properties are non-monetary. The Department of Fish and Wildlife Resources currently leases the following properties:

- Barren River
- Green River
- Dewey Lake
- Fishtrap Lake
- Barlow Bottoms-Olmstead
- Birdsville Island
- Lake Cumberland
- Paintsville Lake
- Sloughs-Grassy Pond

Any expenditure in excess of revenue from each property listed above will be eligible for reimbursement under the Wildlife Restoration and Basic Hunter Education grant (CFDA 15.611) from the U.S. Department of the Interior. The properties listed above are not reimbursed with federal funds if the grant has already been expended to manage other wildlife properties.

Note 10 - Pass Through Programs

OMB Circular A-133 Section 105 defines a recipient as "a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program" and a pass-through entity as "a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program."

Federal program funds can be received directly from the federal government or passed through from another entity. Below is a list of all federal programs that are either (1) passed through, or (2) both direct and passed through.

Received From	Direct/Pass Through (Grantor)	State Agency	Amount
<u>Fund for the Improvement of Education (CFDA 84.215)</u>			
Powell County Board of Education	Pass Through (Various)	KHS	\$
Letcher County Board of Education	Pass Through (Various)	KHS	
Total Fund for the Improvement of Education			<u>\$</u>

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 10 - Pass Through Programs (Continued)

Received From	Direct/Pass Through (Grantor)	State Agency	Amount
<u>Civic Education - We the People and the Cooperative Education Exchange Program (CFDA 84.304)</u>			
Center for Civic Education	Pass Through (Various)	AOC	\$ 410
Total Civic Education – We the People and the Cooperative Education Exchange Program			\$ 410
<u>We the People (CFDA 84.929)</u>			
Center for Civic Education	Pass Through (Various)	AOC	\$
Total We The People			\$

Note 11 - Noncash Expenditure Programs

The Commonwealth's noncash programs and a description of the method/basis of valuation follow.

CFDA	Program Title	Amount	Method/Basis of Valuation
10.551	Supplemental Nutrition Assistance Program	\$ 1,294,692,187	EBT Issuance
10.555	National School Lunch Program	21,001,493	Commodities issued for FY12 per WBSCM report
10.565	Commodity Supplemental Food Program	5,430,123	Commodities issued for FY12 per WBSCM report
10.569	Emergency Food Assistance Program (Food Commodities)	5,931,378	Commodities issued for FY12 per WBSCM report
10.664	Cooperative Forestry Assistance	373,658	Acquisition Cost as indicated by Government Services Administration (GSA)

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 11 - Noncash Expenditure Programs (Continued)

CFDA	Program Title	Amount	Method/Basis of Valuation
39.003	Donation of Federal Surplus Personal Property	461,968	23.7% of federal acquisition cost (\$1,949,232)
66.034	Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	194,760	EPA contracts with Research Triangle Institute for sample analysis
66.419	Water Pollution Control State, Interstate, and Tribal Program Support	277,000	In-kind services valued by the donor, the U.S. Environmental Protection Agency, Division of Water
93.069	Public Health Emergency Preparedness	40,496	Grant Award Document
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	92,846	Grant Award Document
93.268	Immunization Cooperative Agreements	43,923,126	CDC Report
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants	326,040	Grant Award Document
Total Noncash Expenditures		<u>\$ 1,372,745,075</u>	

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)

Note 12 - Activity Occurring in Programs with Inventoriable Items

The Department of Agriculture operates a state-wide Commodity Supplemental Food Program (CFDA 10.565). The dollar value of the inventory, based on the USDA Commodity File dated June 2012 is as follows:

Commodity Supplemental Food Program CFDA 10.565

Beginning Inventory, July 1, 2011	\$ 1,159,463
Received Commodities	5,844,725
Issued to Recipients	(5,430,123)
Net Value of Inventory Adjustments, June 30, 2012	188,082
Ending Inventory, June 30, 2012	<u>\$ 1,762,147</u>

Note 13 - Election Reform Payments (CFDA 39.011)

Interest earned must be used for additional program expenditures.

Note 14 - Pertaining to ARRA Designation

In order to identify ARRA funds on the Schedule of Expenditures of Federal Awards, the prefix will precede the Program Title on the Grantor Schedule.

Note 15 - Zero Expenditure Programs

These programs had no expenditures related to the respective state organization during FY 2012. The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures. For CFDA numbers with multiple state agencies listed, the schedule is presented in descending expenditure amount order.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
*GOVERNMENT AUDITING STANDARDS***



ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

**Report On Internal Control Over Financial Reporting
And On Compliance And Other Matters Based On An Audit Of
Financial Statements Performed In Accordance With
*Government Auditing Standards***

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

We have audited the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the Commonwealth of Kentucky as of and for the year ended June 30, 2012, and have issued our report thereon dated December 14, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Commonwealth is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Commonwealth's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commonwealth's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commonwealth's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of financial statement findings we identified certain deficiencies in internal control over financial reporting that we consider to be material weakness and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of financial statement findings to be a material weaknesses, which are identified as findings 12-CHFS-01, 12-CHFS-02, and 12-FAC-03.



Report On Internal Control Over Financial Reporting
And On Compliance And Other Matters Based On An Audit Of
Financial Statements Performed In Accordance With
Government Auditing Standards
(Continued)

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We consider the deficiencies described in the accompanying schedule of financial statement findings to be significant deficiencies, which are identified as findings; 12-CHFS-04, 12-CHFS-05, 12-CHFS-06, 12-CHFS-07, 12-CHFS-08, 12-DOC-09, 12-DWI-10, 12-DWI-11, 12-DWI-12, 12-DWI-13, 12-DWI-14, 12-DWI-15, 12-FAC-16, 12-FAC-17, 12-FAC-18, 12-FAC-19, 12-JUV-20, 12-JUV-21, 12-JUV-22, 12-JUV-23, 12-JUV-24, 12-KDE-25, 12-KDE-26, 12-KDE-27, 12-KDE-28, 12-KEHP-29, 12-KEHP-30, 12-KEHP-31, 12-KEHP-32, 12-KEHP-33, 12-KHP-34, 12-KHP-35, 12-KST-36, 12-KST-37, 12-KST-38, 12-KST-39, 12-PARKS-40, 12-PARKS-41, 12-PARKS-42, 12-PC-43, 12-PC-44, 12-PC-45, 12-PC-46, 12-PC-47, 12-PC-48, 12-PC-49, 12-TC-50, 12-TC-51, 12-TC-52, 12-TC-53, 12-TC-54, and 12-TC-55.

Compliance and Other Matters

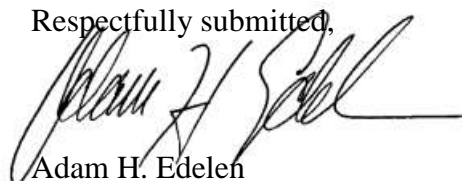
As part of obtaining reasonable assurance about whether the Commonwealth's financial statement for the year ended June 30, 2012, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Management's response to the findings identified in our audit is described in the accompanying comments and recommendations. We did not audit management's response and, accordingly, we express no opinion on it.

We noted certain matters that we reported to management in separate letters.

This report is intended solely for the information and use of management, of the Commonwealth of Kentucky, others within the entity, and the General Assembly and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Adam H. Edelen
Auditor of Public Accounts

December 14, 2012

FINANCIAL STATEMENT FINDINGS

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-01: The Cabinet For Health And Family Services Year-End Closing Package Contained Errors In The Calculations For Deferred Revenue And Accounts Receivable That Were Not Detected By The Agency

During the fiscal year 2012 audit of the Cabinet for Health and Family Services (CHFS) accounts receivable, errors were noted in the closing package. CHFS failed to submit the correct accounts receivable information on the closing package to the Finance and Administration Cabinet. Deferred revenue was overstated by \$382,021 and revenue earned and not received was understated by \$522,666,296.

The report used for reporting Federal deferred revenue did not distinguish between Federal funds and American Recovery and Reinvestment Act (ARRA) funds. Both funds were included in the federal deferred revenue; however, ARRA funds should have been excluded because they are required to be accounted for separately. This caused an overstatement by \$382,021 on the closing package for several departments within CHFS.

The staff in the Division of General Accounting preparing and submitting the closing package receives information from the various departments; however, they do not verify the information is correct. The Department of Child Support submitted an inaccurate report to the Division of General Accounting and it was included in the 2012 closing package causing the revenue earned and not received to be understated by \$522,666,296. Due to our inquiry the Division of Child Support corrected their report and the Division of General Accounting corrected and re-submitted the closing package forms to the Finance and Administration Cabinet.

Originally the total accounts receivable reported in the closing package submitted to the Finance and Administration for reporting in the Commonwealth's Comprehensive Annual Financial Report (CAFR) were underreported by \$522,284,275 resulting in a material misstatement.

Good internal controls dictates procedures to be in place to ensure that all reports used for financial reporting are accurate and complete. It also requires that personnel be up to date on reporting regulations and requirements to ensure that all funds are recorded correctly.

Recommendation

We recommend the Cabinet for Health and Family Services incorporate the following procedures to ensure accurate and complete reporting:

- Implement a thorough review process of the closing package to ensure accuracy. Verify the information submitted by the various departments is complete and accurate, including agency reports.

FINANCIAL STATEMENT FINDINGS***Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-01: The Cabinet For Health And Family Services Year-End Closing Package Contained Errors In The Calculations For Deferred Revenue And Accounts Receivable That Were Not Detected By The Agency (Continued)**

Management's Response and Corrective Action Plan**DGA Management's Response and Corrective Action Plan**

The Division of General Accounting concurs with the findings. The error of \$382,021 overstatement in 1200 fund was human error. To help eliminate the chance for human error, management will work with the Cabinet's report writer to design standardize reports that prompt for basic information at the end user level. The reports will be constructed and designed to report the information as close to the closing package format as possible to limit human interaction in retrieval of information and avoid the need to manipulate data thereby limiting the opportunities for human error.

In reviewing the information supplied by agencies for accuracy, backup documentation is required and DGA staff check the information that is submitted. However, DGA does not have access to other agencies' secure databases and cannot verify the accuracy of the information. This incident related to the Agency 727 issue was not eMars information but was derived from internal system records. To prevent future errors, DGA will check the total provided by the Department for Income Support on the AFR 34 to the spreadsheet given to them from Department for Income Support for the AFR 30 and 31. If the amounts do not match, DGA will send the spreadsheet back to the Department for Income Support.

Department for Income Support Management's Response and Corrective Action Plan

The Department for Income Support (DIS) concurs with the finding. Revenue earned and not received was inadvertently understated in the closing package. It is noted, however, that all of the reports submitted to the federal government and the AFR 34 were correct. As soon as (DIS) was made aware of the error on the spreadsheet, immediate corrective action was taken on the closing report. In the future, DIS staff will compare the AFR 34 report to the AFR 30 and 31 spreadsheets to ensure they both match in total. In addition, management will thoroughly review all closing package information before it is sent to the Division of General Accounting.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-02: The Cabinet For Health And Family Services Failed To Record Medicaid Benefits As Accounts Receivable In The Closing Package

During the fiscal year 2012 audit of the Cabinet for Health and Family Services (CHFS) accounts receivable, errors were noted in the closing package. CHFS failed to submit the correct accounts receivable information on the closing package to the Finance and Administration Cabinet. Accounts receivable for revenue earned, but not received was understated by \$327,605,326 in federal funds.

The amount understated was recorded as accounts payable for Medicaid Benefits which requires federal reimbursement and should be recorded as an accounts receivable. The amount understated was not properly included in accounts receivable as revenue earned, but not received for the Department of Medicaid Services. Oversight and insufficient review of the closing package resulted in an inaccurate closing package being submitted to the Finance and Administration Cabinet for reporting in the Commonwealth's Comprehensive Annual Financial Report (CAFR) resulting in a material misstatement.

Adequate controls on the closing package should be in place and functioning effectively. Processes and procedures should be in place to ensure the closing package is complete and reported accurately.

Recommendation

We recommend the Cabinet for Health and Family Services thoroughly review the closing package to ensure complete and accurate information is presented.

Management's Response and Corrective Action Plan

The Division of General Accounting agrees with the finding and will ensure accurate and complete information is presented in the future.

The CHFS closing package will be thoroughly reviewed by a Branch Manager as well as senior Division of General Accounting staff. The error on this year's package was discovered after submission but prior to finalization of the Comprehensive Annual Financial Report (CAFR) after a secondary review by the Division of General Accounting and the Finance and Administration Cabinet, Office of the Controller. Since it was corrected prior to publication, the error had no material effect on the Commonwealth's financial statements or any federal reports. In the future, multiple internal reviews prior to submission of the closing package will provide sufficient internal controls to prevent these errors.

FINANCIAL STATEMENT FINDINGS***Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-02: The Cabinet For Health And Family Services Failed To Record Medicaid Benefits As Accounts Receivable In The Closing Package (Continued)**

Auditor's Reply

We would like to reiterate the significant impact the understatement would have caused on the Commonwealth's Comprehensive Annual Financial Report if the error had not been detected. CHFS submitted the erroneous closing package to the Finance and Administrative Cabinet; therefore, the lack of internal control in the initial review process is the basis of the material weakness. We are pleased to hear the agency is implementing a more thorough review process for next year to prevent such significant errors in the future.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-03: The Finance And Administration Cabinet Did Not Ensure All Website Content Was Adequately Reviewed Prior To Placement On A Publicly Accessible Website

Our fiscal year (FY) 2012 review of the Finance and Administration Cabinet (Finance) revealed a lack of adequate oversight for the website content upload process, which manifested itself in personally identifiable information (PII) being made available on the Finance publically accessible website. Had an adequate review process been established, the PII could have been detected and expunged prior to placement on the website.

Finance completed an upgrade of their public website in April 2012. The website management vendor created an empty shell for the upgraded website and granted Finance content editors and managers access to the content management software. In conjunction with the upgrade, Finance requested that all internal offices update the contact information to be placed on the website. In response to this request, one office submitted a Microsoft Excel workbook containing three worksheets to the Office of the Secretary. The first and third worksheets contained staff names and organizational units. The second worksheet contained names, social security numbers, birth dates, home phone numbers and additional employee position data for current and former staff. Personnel in the Office of the Secretary reviewed only the first worksheet in the Excel workbook and failed to identify the PII residing in the second worksheet. As a result of this oversight, the workbook was published in its entirety on the Finance public website. A Finance employee discovered the PII on the website within two days after its publication, and the workbook was removed within two hours of discovery. Finance then worked with the website management vendor to ensure there were no saved versions of the webpage on the Internet. The Commonwealth Office of Technology (COT) also reviewed access logs with the vendor to determine who had accessed the webpage while the PII was available. Finance confirmed the primary Internet search engines deleted the webpage containing PII six days after Finance removed the workbook. No suspicious website visitors were identified during the time the PII was available. Upon discovery, Finance notified the Office of the Governor, the Personnel Cabinet, and the Office of the Attorney General. The affected current employees were notified by hand delivered letter and former employees were notified by certified mail.

During discussions with Finance and the website management vendor, it was determined a new Statement of Work (SOW) was not created for this website upgrade. In addition, no project plan was created with deliverable dates. The auditor reviewed the existing SOW from 2005-2006 and contract established for the original website design and determined there was no specific language requiring a review or scan for PII to be performed by the vendor. The vendor stated they executed a scan on the website content, which failed to identify the PII. The vendor was attempting to ascertain the cause of the software malfunction.

Finance stated they were in the process of creating an Incident Response Policy, which would list procedures and contacts in the event a similar incident occurs in the future. The website management vendor also offers training on the content management software, in which they discuss the types of information that should not be placed on a public website. COT staff indicated they were contemplating the issuance of a new PII standard and/or newsletter to highlight the importance of protecting PII. The vendor stated their software training would address any new COT standards.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-03: The Finance And Administration Cabinet Did Not Ensure All Website Content Was Adequately Reviewed Prior To Placement On A Publicly Accessible Website (Continued)

Failure to adequately review website content prior to production implementation increases the risk that PII could be made available to the general public, which could compromise the identities of employees or vendors.

A thorough review process should be in place to approve all proposed website changes. All approved and promoted changes should be free of PII.

Recommendation

We recommend Finance create and implement a written website content review policy, which should include, at a minimum, the following:

- Definition of PII;
- Listing of positions responsible for content review prior to production promotion;
- Steps to be followed by the reviewer to ensure no PII is contained within the proposed website content;
- Documentation retention requirements to substantiate the review process; and,
- Listing of positions responsible for production promotion subsequent to review.

In addition, we recommend Finance finalize its Incident Response Policy and work with the website management vendor to ensure all content editors and managers with access to the content management software are properly trained to carry out their responsibilities. Finance should also work with COT to ensure any newsletters or new standards related to PII are distributed to key personnel with website editing responsibilities. Moving forward, Finance should ensure all work with the website management vendor is documented in a new SOW, and a project plan should be created to document each project milestone. The SOW should clearly define agency and vendor responsibilities with regard to content.

Management's Response and Corrective Action Plan

As noted above, the incident in question was isolated and immediately addressed by the Cabinet. APA became aware of the incident as part of the notification process and meetings with the Cabinet. The Cabinet provided training to all content managers, both before and after the incident in question. The Cabinet acknowledges that a Statement of Work would have been informative, but actions were taken based on the terms and conditions of existing contracts. Independent scans were part of the production process as a compensating control, and as noted above, these scans failed to detect the information in question. As part of the Cabinet's policy review, an Incident Response Policy has been finalized and is undergoing the formal review and approval process.

FINANCIAL STATEMENT FINDINGS***Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 12-FAC-03: The Finance And Administration Cabinet Did Not Ensure All Website Content Was Adequately Reviewed Prior To Placement On A Publicly Accessible Website (Continued)**

Auditor's Reply

Although the Finance Incident Response Policy will provide directives if a similar incident occurs in the future, Finance should establish a process to review and approve content prior to being posted to the production website. Therefore, we reiterate the need to develop a proactive written website content review policy to protect sensitive and confidential information.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-04: The Cabinet For Health And Family Services Did Not Obtain Adequate Documentation When Recording Cash Receipts**

During the fiscal year 2012 audit of the Cabinet for Health and Family Services (CHFS), a weakness was noted related to insufficient documentation for cash receipts. CHFS did not provide sufficient evidence for seven cash receipts, which total \$269,452. The auditor was therefore unable to agree the seven cash receipts to the original documentation.

A lack of controls and oversight of documentation at CHFS has led to insufficient tracking of cash receipts documents related to revenue from the Managed Care Organizations (MCO's), specifically Impact Plus revenues.

The Cabinet for Health and Family Services Cash Receipt Policy for Deposits states:

11. The agency submitting receipts must determine where the funds are to be credited. The entire accounting string must be included to ensure proper posting of the funds.
12. All receipts delivered to the ARB must have a transmittal sheet. A newly developed Excel transmittal sheet is attached and may be used in the absence of an existing agency transmittal. This transmittal sheet will automatically total the deposit after the following information has been entered. An agency may design a custom transmittal sheet as long as all the information listed below is included:
 - List of each individual check, including the name on the check, the check number, and amount to be deposited;
 - Total number of checks and the total amount to be deposited;
 - Total amount of cash to be deposited;
 - Agency number and the appropriate accounting string (to which to code the funds);
 - Name, phone number, of the person who completed the transmittal sheet or the name(s), phone number(s), of the individual(s) to be contacted if different from the person who completed the transmittal

Recommendation

We recommend CHFS ensure cash receipt policies are followed and adequate documentation for receipts is received.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-04: The Cabinet For Health And Family Services Did Not Obtain Adequate Documentation When Recording Cash Receipts (Continued)**

Management's Response and Corrective Action Plan

The Division of General Accounting (DGA) respectfully disagrees with this finding. DGA has the appropriate documentation for these deposits. The agency emails the spreadsheet with the information and DGA sends the spreadsheet back with the CR confirmation. Therefore, DGA keeps both a paper copy that is filed and an electronic copy of the documentation.

The Impact Plus deposits are all EFT's. There are two templates designed for each deposit situation: 729 WTIMP and 736 WZIMP. These templates identify the agency and the entire accounting string. The total amount of the deposit is also included on the spreadsheet. There are no checks to list, and the spreadsheet is completed by the reconciling agency and sent email, which creates a paper trail of who is submitting the deposit. The submitting agency is responsible for matching the EFT's to their payment information and the bank notification that is sent to them.

Auditor's Reply

We would like to reiterate that the documentation provided to the auditor during the audit was not sufficient. The information provided to the auditor to test the EFT receipts was a spreadsheet with an accounting string and amount of deposit. This documentation was not sufficient evidence to agree the receipt to the payment information. If a reconciliation was performed by another agency, which was not brought to the auditor's attention, then that support should be attached to the spreadsheet and submitted to the Division of General Accounting (DGA) for their review prior to processing the receipt.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-05: The Cabinet For Health And Family Services Failed To Maintain Proper Payroll Records In Estill County

During the fiscal year 2012 audit of the Cabinet for Health and Family Services (CHFS), concerns were brought to the auditor's attention regarding payroll issues in the Department for Community Based Services (DCBS) Southern Bluegrass Region for Estill County. We tested twelve employee payroll records for employees from this Unit, which consisted of reviewing the CHFS master list of employees, timesheets, leave/overtime forms (CHFS-2), Kentucky Human Resource Information System (KHRIS) screen prints, and the Personnel Action Requests (PARs). We noted the following exceptions:

- Two employees were missing timesheet and all related CHFS-2 forms.
- Two employee timesheets were not accurately entered into KHRIS.
- Three employees did not have CHFS-2 forms to support their timesheet.
- One employees' CHFS-2 form was not signed by a supervisor and the totals of the CHFS-2 form did not agree to the timesheet.

Expenditures including payroll should be supported by documentation that agrees to the amount paid for that expenditure. Lack of controls can lead to errors and omission as described above in which these payroll expenditures were not adequately substantiated by the documentation including timesheets, properly approved leave request, and overtime forms.

In addition, we were informed during our request for information that the timesheets were destroyed by a former employee. We were able to review two of the twelve timesheets requested. Without proper document retention we were unable to verify the missing timesheets and overtime records reported in KHRIS were accurate.

Good internal controls over payroll dictate that payroll charges should be supported by adequate documentation including signed timesheets, leave and overtime forms that detail and substantiate hours and times worked by each employee. In addition, all documentation should be maintained to support any and all entries in the KHRIS system. Strong internal controls are essential in safeguarding employee records from being misused, lost, or destroyed.

Recommendation

We recommend CHFS develop a more efficient system in processing its payroll and take a high priority in safeguarding employee payroll records. This process should consist of the following:

- Maintain all supporting documentation to support any and all entries into the KHRIS system.
- Perform routine audits on the payroll files kept at the local DCBS offices to ensure that all employee payroll records are accounted for.
- Stress to each timekeeper, employee, and supervisor the importance of following procedures consistently under any circumstance and safeguarding the employee payroll records

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-05: The Cabinet For Health And Family Services Failed To Maintain Proper Payroll Records In Estill County (Continued)**

Recommendation (Continued)

- Develop and implement reconciliation procedures to verify all entries submitted by the timekeeper have been properly entered payroll into KHRIS.
- Perform proper review to verify the information on the timesheet to the reported leave and/or overtime reported on CHFS-2 form for accuracy and also for the appropriate approval on any leave or overtime.

Management's Response and Corrective Action Plan

We believe this was an isolated incident of an employee misunderstanding proper procedure for records retention. Although this employee is no longer employed with DCBS, we clearly communicated proper procedures to the supervisor and Service Region Administrator Associate on August 13, 2012. In addition, a reminder was sent to all CHFS timekeepers on August 28, 2012 regarding the importance of following the records retention schedule.

Auditor's Reply

The agency has indicated in the management response that the finding was a result of an isolated incident of one employee. We would like to readdress the recommendation of routine audits on the payroll files at local DCBS offices to ensure this was an isolated issue. In addition, we would like to reiterate the importance of safeguarding payroll records to ensure questionable payroll activity did not occur. We are pleased that CHFS is sending reminders to CHFS timekeepers about the importance of following the record retention schedule; however, further action should be considered.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-06: The Cabinet For Health And Family Services Was Inconsistent In Their Determination Of Advanced Payments To Impact Plus Providers And Did Not Maintain Proper Support For Reimbursement Of Advanced Payments**

During the fiscal year 2012 audit of the Cabinet for Health and Family Services (CHFS), we tested a sample of transactions to verify the expenditure was recorded appropriately and had adequate support. Four of these transactions consisted of payments to two different providers in the Impact Plus program. While reviewing these transactions, the auditors noted they were advanced payments paid to the providers to aid them during the transition from a Fee-for-Service model to the Managed Care Organizations (MCOs). The transition from a Fee-for-Service model to the MCOs resulted in payment of claims not being made timely. These advancements were requested by Legislators and the Impact Plus provider community because they could not continue to provide services and meet their payroll obligations without payment from the MCOs. Based on accounting records, a total of \$2,869,833 was advanced to Impact Plus providers as of June 30, 2012. As of that date, \$463,000 had been repaid by the Impact Plus providers to CHFS. Although CHFS maintained records of the advanced amounts based on estimates, year-end summary data provided to the auditors omitted interim payments from the Impact Plus providers which were based on claims in the system. CHFS did not maintain proper support of reimbursement from the advancement. The auditors utilized the State accounting system, eMARS, to determine the amount of reimbursement from the advancement.

In addition, the methodology in determining advancement amounts was inconsistent among Impact Plus providers. CHFS based a portion of the advancement on actual claims that had not properly processed in either the State or MCO Medicaid Management Information System (MMIS). The other portion of the advancement to the providers was based on internal estimates made by CHFS. Rather than using a methodology the auditors could recalculate, confirm, and apply to all of the providers, CHFS based the advancement estimates partly on historical data and partly on intangible internal assessment.

Furthermore, the outstanding balances of the advancements from the providers were not properly accounted for at fiscal year end. The amount due to CHFS should have been considered accounts receivable at fiscal year end. CHFS did not recognize the outstanding balance as a part of their account receivable.

Ordinarily, CHFS pays the MCOs a per member, per month capitation fee. Providers submit Medicaid claims to the MCOs, wait for the claims to process, and are then paid by the MCOs for the services rendered. The Impact Plus program, however, adds a step to the payment process. Rather than the MCOs directly paying the Impact Plus providers, the MCOs pay CHFS for processed claims. CHFS then pays the providers. Ineffective communication and improper planning regarding the specificities of the Impact Plus program led to payment issues during the transition to an MCO environment.

Impact Plus provider claims are handled differently than other providers in the Medicaid Program. Impact Plus providers are paid by CHFS and the MCOs did not properly plan for the timely payment of the Impact Plus claims through the transition from the Fee-for-Service to MCO environment.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-06: The Cabinet For Health And Family Services Was Inconsistent In Their Determination Of Advanced Payments To Impact Plus Providers And Did Not Maintain Proper Support For Reimbursement Of Advanced Payments (Continued)

It is understood these advanced payments were vital in order to sustain the Impact Plus program. Nevertheless, the inconsistent methodology in determining the advancement amounts and the lack of controls on tracking the reimbursement are both problematic. Because of the inconsistent nature of the internal assessments, the process could face accusations of bias or unfairness toward certain providers based on the amounts of the advancement.

Although CHFS did base a portion of the loans on actual claims that had not properly processed in either the State or MCO Medicaid Management Information System (MMIS), the current standing of a portion of these claims is unknown and is being reviewed by CHFS. The Impact Plus providers were expected to pay CHFS back once they had received payment for processed claims. Because many of the claims are not processing as expected, CHFS is not being repaid for these advancement in a timely fashion.

While this may be an unusual circumstance, it is necessary for CHFS to properly account for advancements at year end. By not including these advancements on year-end summary data, regardless of whether CHFS personnel are aware of their existence, CHFS could erroneously report or misstate receivable balances.

Poor planning and communication between CHFS and the MCOs created an environment in which Impact Plus providers suffered severe hardship to the point of, in some cases, potentially not meeting payroll obligations. Had CHFS and the MCOs been better prepared for the transition, neither CHFS nor the Impact Plus providers would have been in a situation where such substantial advancements were necessary. Furthermore, these circumstances could lead to a breach of trust between the Medicaid provider community and CHFS. If the providers are not compensated, their ability to deliver healthcare services to Medicaid members could be compromised.

42 CFR 447.45(d)(2,3,4) states,

“The agency must pay 90 percent of all clean claims from practitioners, who are in individual or group practice or who practice in shared health facilities, within 30 days of the date of receipt. The agency must pay 99 percent of all clean claims from practitioners, who are in individual or group practice or who practice in shared health facilities, within 90 days of the date of receipt. The agency must pay all other claims within 12 months of the date of receipt...”.

42 CFR 447.46(c)(1) states,

“A contract with an MCO must provide that the organization will meet the requirements of §§774.45(d)(2) and (d)(3)...”.

Proper internal controls dictate that policies and procedures should be created and documented to provide direction to staff in regards to advance payments to providers. These policies and procedures should guide staff in determining the amount of advancement estimated to providers. If loans are based on provider hardship, such policies should dictate what factors will be considered in assessing the magnitude or severity of the hardship.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-06: The Cabinet For Health And Family Services Was Inconsistent In Their Determination Of Advanced Payments To Impact Plus Providers And Did Not Maintain Proper Support For Reimbursement Of Advanced Payments (Continued)

In 1993, The Program Review and Investigations Committee authorized a study of the Medicaid program (LRC Research Report No. 274). The goal of that report was to identify problems in the administration of the program. The report contained several recommendations related to financial accountability. Two of the report's recommendations were particularly relevant to the issues noted during the 2012 audit. Those recommendations were numbers 6 and 7: (6) [CHFS] should determine the legality of making advance payments and discharging overpayments and (7) [CHFS] should develop policies to define hardship. These recommendations highlighted the lack of policies and procedures governing interim loans disbursed to providers and the determination of loan amounts based on hardship. The methodology for advance payments per the Department of Medicaid Services at that time -75% of pending claims or the previous month/ prior year monthly average-was not followed in this instance and reveals inconsistencies in how CHFS determines short term loan amounts to providers.

Recommendation

We recommend CHFS:

- Create a method for accurately tracking payments from Impact Plus providers to CHFS to ensure full reimbursement on the advancement.
- Determine a methodology in determining advancement amounts which only include those claims for which existence has been confirmed and adjudication is reasonably certain. In addition, if estimates must be used as the basis for short term loans, base the amounts on clearly defined measurements.
- Ensure proper accounting of accounts receivable is performed to account for outstanding balances of advancements.
- Document the issues faced during this transition and apply that information to the State's current and future efforts in the expansion of Managed Care to avoid similar problems.
- Develop policies to define hardship which would result in advance payments. In addition, define clear parameters for determining future advancement amounts if CHFS determines hardship is evident.
- Improve communication between CHFS and the Impact Plus provider community to be more transparent so providers can prepare for potential funding issues.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-06: The Cabinet For Health And Family Services Was Inconsistent In Their Determination Of Advanced Payments To Impact Plus Providers And Did Not Maintain Proper Support For Reimbursement Of Advanced Payments (Continued)

Management's Response and Corrective Action Plan

- *DBHDID has accounted for all advance payments to Impact Plus subcontractors. Detail of reimbursement from the advancement utilizing a spreadsheet that was created during fiscal year 2012 specifically for this purpose. Each sub-contractor that received funds is listed along with the amount each received. As reimbursements are received, those amounts are entered onto the spreadsheet. The current balance due from each sub-contractor is available at any time. Payments received are applied to each Impact Plus sub-contractor's outstanding balance. During the current fiscal year all Impact Plus sub-contractors with outstanding balances were sent communication requesting full payment by the end of FY13.*
- *Issues were raised concerning the rationale for developing two different methods for making interim payments. Theoretically, we agree with the auditor's comment that: "advancement amounts which only include those claims for which existence has been confirmed and adjudication is reasonably certain. In addition, if estimates must be used as the basis for short term loans, base the amounts on clearly defined measurements." Our initial attempts to determine a reasonable and equitable basis was based on requesting pending claims from each MCO. It was soon discovered that a large number of providers (because of the use of third party billing/processing agents used by some providers as well as MCOs) were having difficulty successfully submitting claims; therefore, the pending claims data did not provide a reasonable or equitable basis for making advance payments. To compensate for the lack of accurate data, DBHDID devised a methodology that based future interim payments on a two month estimate of Impact Plus payments prior to the implementation of managed care. DBHDID feels that basing interim payments on two months of most recent payments history provided the best estimate to ensure fairness to Impact Plus subcontractors, given the time sensitive nature of the payment issue.*
- *As indicated above, all repayments are applied to each sub-contractor's outstanding balance. Existing funds were utilized to make advance payments and did not result in additional revenues to DBHDID. When payments are received they are applied as a reduction to expenditures.*
- *With the expansion of managed care for behavioral health services in Region 3 it is the expectation of DBHDID for the Managed Care Organizations to meet the Impact Plus payment and service obligations. As the Impact Plus Provider, DBHDID recognizes the importance of maintaining our sub-contractor network.*
- *Two of the current MCOs will be participating in the expansion of Managed Care. DBHDID staff are working with the new MCOs to develop processes prior to the go live implementation of the new Region 3 MCOs scheduled for January 2013. In addition, DBHDID Impact Plus staff is reaching out to sub-contractors in region 3 to ensure a smoother transition.*

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-06: The Cabinet For Health And Family Services Was Inconsistent In Their Determination Of Advanced Payments To Impact Plus Providers And Did Not Maintain Proper Support For Reimbursement Of Advanced Payments (Continued)**

Management's Response and Corrective Action Plan (Continued)

- *If it should become necessary to make advance payments, DBHDID will require each sub-contractor to formally request assistance. Sub-contractors will be required to demonstrate a financial hardship before DBHDID will issue an interim payment. The parameters to determine financial hardship will be developed and implemented by January 31st 2013. DBHDID will base any future interim payments on a two month average of Impact Plus payments.*

Four provider trainings were held by DBHDID during the week of December 3rd in order to prepare the sub-contractors for the second phase of Managed Care Implementation in Region 3. Each training was facilitated by one of the MCOs and provided the sub-contractors with detailed information about their clinical processes as well as claims and billing procedures. DBHDID is available to sub-contractors on a daily basis for technical assistance and to serve as a liaison between the IMPACT Plus Sub-contractors and the MCOs. Conference calls have been coordinated between each MCO and the IMPACT Plus Sub-contractors during which provider questions can be answered and concerns addressed. DBHDID has daily communication with the MCO regarding the processing of payment and hosts frequent Department level meetings with each MCO in which sub-contractor issues are shared. IMPACT Plus Central Office staff are also invited to and participate regularly in multiple provider forums statewide including Regional Provider Meetings, Children's Alliance Meetings, etc. These forums provide the sub-contractors the opportunity to ask questions, express concerns, and troubleshoot problems with Department staff.

In order to further facilitate communication between the IMPACT Plus Sub-contractors and the MCOs, DBHDID hosted two full days of meetings between the sub-contractors and all three MCOs in January 2012. Sub-contractors were given the opportunity to schedule a one on one appointment with each MCO to address any claims submission, billing, prior authorization, or payment issues they were experiencing. DBHDID issued a follow up survey to solicit sub-contractor feedback related to usefulness of these forums and gauge interest for future meetings facilitated by DBHDID. Based on the feedback received, we anticipate that a similar meeting will be held in February as part of the second phase of Managed Care implementation in Region 3. DBHDID has shown and continues to be committed to ensuring its sub-contractors are receiving payment and can continue to provide uninterrupted, high quality services to the children of the Commonwealth.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-07: The Cabinet For Health And Family Services Hazelwood Facility Failed To Ensure Proper Controls Are Followed Resulting In Late Payments, Unauthorized Expenditures, Insufficient Documentation, And Improper Procurement

During the fiscal year 2012 audit of the Cabinet for Health and Family Services (CHFS), we tested a sample of expenditures at the Hazelwood Intermediate Care Facility to verify controls were in place and that expenditures were accurate and complete. Auditors continue to note an improvement in the accounting practices at Hazelwood; however, weaknesses are still evident. The following exceptions were noted:

- One electric bill was not paid by the due date and late charges of \$71 were incurred.
- One purchase request did not have evidence of authorization or approval.
- Two procurement card purchases of food were classified generically as ‘Procurement Card Purchases’ rather than ‘Food Products.’
- Three procurement card purchases of movie theater gift cards could not be traced to actual expenditures beyond the purchasing of the gift cards.
- Two transactions had unsigned Executive Orders attached in eMARS.

Employee turnover, particularly in leadership positions, continues to hinder Hazelwood’s year over year improvement. Over the last two years Hazelwood has had four individuals work in the capacity of the Business Office Manager. This continual turnover makes establishing an acceptable accounting environment difficult.

A lack of controls and poor accounting practices at Hazelwood resulted in the weaknesses noted. If the accounting process allows for billing due dates to be missed the cumulative effect of the late charges could be substantial. When proper internal controls are not followed and purchase requests lack authorization then unauthorized charges could occur. Failure to properly categorize purchases in eMARS jeopardizes the quality of reports relied upon by management which could prevent Hazelwood from properly budgeting future expenses. In addition, if Executive Orders are often used in lieu of contracts there is a risk of inappropriate spending.

The current payment methodology for financing resident trips to movie theaters is a fraud risk. Hazelwood purchases movie theater gift cards at \$500 each using a procurement card; however, reconciliation between the theater gift cards to the actual expenditures is not performed. Since many gift cards are used, expenditures and remaining balances are difficult to track. The gift card check-out log does not include individuals who are attending the movie. Because internal tracking sheets do not note individual attendees, and the theater receipts only show a total quantity of tickets purchased, this creates a risk of non-residents attending the movie.

Well designed internal controls ensure that expenditures are authorized, properly categorized, paid in a timely manner, and reduce the risk of fraud, waste, and abuse. Good internal controls also dictate that the method by which expenditures are authorized and/or executed—contracts, procurement cards, or stand alone purchases—limits the potential for misuse of State funds.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-07: The Cabinet For Health And Family Services Hazelwood Facility Failed To Ensure Proper Controls Are Followed Resulting In Late Payments, Unauthorized Expenditures, Insufficient Documentation, And Improper Procurement (Continued)

Recommendation

We recommend:

- The business office at Hazelwood strengthen their internal controls to ensure that expenditures are authorized, properly categorized, and that invoices are paid in a timely manner to avoid late fees.
- Hazelwood determine an alternative method for financing resident trips to the theater. Direct billing through a contractual arrangement or paying for admission with a Procurement Card would be more transparent and preferable compared to using multiple gift cards.
- Hazelwood pursue a contractual relationship with vendors so that the Executive Order authorization is only used when necessary as it was intended.

Management's Response and Corrective Action Plan

Recommendation: The business office at Hazelwood strengthen their internal controls to ensure that expenditures are authorized, properly categorized, and that invoices are paid in a timely manner to avoid late fees.

Response: As noted by the APA, the Hazelwood business office has struggled with employee turnover. The business office staff is currently in the process of reviewing all internal procedures related to the procurement function. A new position within the office was filled effective December 1, 2012. This employee has attended trainings conducted by CHFS Division of Procurement Services. This employee's primary responsibility will be oversight of procurement procedures in order to ensure compliance with KRS 45A. New and/or revised Hazelwood Policies & Procedures will be developed as indicated through the oversight process. Business office staff will be trained on all updates by the Fiscal Manager or designee. This will be an ongoing process.

Recommendation: Hazelwood determine an alternative method for financing resident trips to the theater. Direct billing through a contractual arrangement or paying for admission with a Procurement Card would be more transparent and preferable compared to using multiple gift cards.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-CHFS-07: The Cabinet For Health And Family Services Hazelwood Facility Failed To Ensure Proper Controls Are Followed Resulting In Late Payments, Unauthorized Expenditures, Insufficient Documentation, And Improper Procurement (Continued)**

Management's Response and Corrective Action Plan (Continued)

Response: *The Hazelwood Business Office has established formal processes in regards to tracking resident trips to movie theaters. In November 2010, the number of ProCard holders was decreased to allow increased management control. Due to the fact that direct care staff accompany the resident on trips and direct care staff are not approved ProCard holders, tickets must be purchased in advance. The exact number of residents and the actual direct care staff that will be attending is not always known until the day of the trip (residents may become ill, change their minds, etc). The movie cards are signed out with required information and all receipts are submitted with the movie card. The staff member that signs the movie card out is held responsible for any discrepancies.*

Recommendation: *Hazelwood should pursue a contractual relationship with vendors so that the Executive Order authorization is only used when necessary as it was intended.*

Response: *The Hazelwood Business Office is actively reviewing its purchasing history and Purchase Requisitions to determine when it is appropriate and feasible to pursue contractual relationships and which type of contract is most appropriate. In addition, as part of the approval/review of Purchase Orders (PO), all of the attached documents are reviewed both at Hazelwood and at the Cabinet/Departmental central office level prior to final approval being placed on a PO. Due to the fact purchasing needs are subject to change based on the needs of the facility, this will be an ongoing process.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-08: The Cabinet For Health And Family Services' Department For Medicaid Services Did Not Ensure All System Audits And Edits Are Accurately Configured For The Kentucky Medicaid Management Information System And Up-To-Date Documentation Was Retained

As noted in the prior year audit, our fiscal year (FY) 2012 audit of the Cabinet for Health and Family Services (CHFS) Kentucky Medicaid Management Information System (KYMMIS) revealed the Department for Medicaid Services (DMS) did not maintain updated documentation of all programmed audits and edits performed during KYMMIS system processing. System edits ensure the data within a transaction is complete, accurate, and formatted correctly; whereas, system audits provide a check against historical transactions to ensure the current claim is valid and allowable. Multiple instances of inactive system audits or edits continued to be identified as active, whereas multiple active audits and edits were omitted from the associated documentation. In addition, several audits and edits were incorrectly configured.

DMS uses audits and edits within the KYMMIS application for quality assurance purposes. This process ensures data input is accurate and complies with Medicaid eligibility guidelines. DMS created two manuals to document the available KYMMIS audits, which are the KYMMIS Audit Manual and the KYMMIS Claim Check Manual. In addition, DMS created the KYMMIS Edit Manual to document KYMMIS edits.

Of the 459 programmed audits tested, we determined the following:

- Twenty-three audits not identifying exceptions for FY 2012 were determined to have been operating incorrectly or needed to be researched further to determine whether they are active. These audits are currently listed in the Audit Manual as active.
- Seventy-one audits with no exceptions for FY 2012 were documented within the Audit Manual to be active; however, according to DMS, they are currently inactive or end-dated.
- Three audits included in the FY 2012 listing of active audits were not included in the Audit Manual or the Claim Check Manual and there were no exceptions since the prior year. According to DMS, two of the three audits are inactive, and one is active.
- Two audits were included in both the Audit Manual and Claim Check Manual as active audits, but there were no exceptions since the prior year audit. According to DMS, the two audits were active, but are no longer applicable based on the outdated parameters of the audit criteria.
- Fourteen audits were identified as active in the Audit Manual, but had no exceptions for FY 2012. According to DMS, these audits are no longer applicable due to outdated parameters of the audit criteria.
- One audit had no exceptions during the FY 2010 or the FY 2011 audit and DMS noted during FY 2011 that it was no longer applicable; however, it was not included in the Audit Manual.
- Six audits had exceptions during the FY 2011 and the FY2 012 audits, but were not included in the Audit Manual. According to DMS, these audits are active and a Change Order was opened to add pages in the Audit Manual; however, the pages have not been added to the current Audit Manual.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-08: The Cabinet For Health And Family Services' Department For Medicaid Services Did Not Ensure All System Audits And Edits Are Accurately Configured For The Kentucky Medicaid Management Information System And Up-To-Date Documentation Was Retained (Continued)

- Two audits had exceptions during the FY 2011 audit, and, according to DMS, were still active during FY 2012. However, they were not included on the FY 2012 listing of active audits provided by DMS, and were not included in the Audit Manual. A Change Order was opened to add pages in the Audit Manual; however, the pages have not been added to the current Audit Manual.
- Three audits had exceptions during the FY 2011 audit, but were not included on the FY 2012 listing of active audits provided by DMS. Further, the audits were not included in the Audit Manual. According to DMS, these audits were no longer active as of a specific date.
- One audit had exceptions during the FY 2011 audit, but was not included on the FY 2012 audit listing of active audits provided by DMS. Further, the audit was not included in the Audit Manual. According to DMS, this audit is inactive.
- One audit was on the FY 2012 listing of active audits, but was not identified in the Audit Manual. According to DMS, further research was necessary to determine if the audit is active or inactive.

Of the 796 programmed edits tested, we determined the following:

- One edit was included in the Edit Manual as active, but DMS indicated further research was necessary to determine whether this edit was active or inactive.
- One hundred and eight edits were identified in the Edit Manual as active, but according to DMS, they are currently inactive or no longer valid; however, the documentation was not updated to properly reflect this status.
- Eighty-three edits were on the FY 2012 listing of active edits, but were not identified in the Edit Manual. According to DMS, these edits are currently either inactive or no longer valid for the system.
- Forty edits were on the FY 2012 listing of active edits and had exceptions during FY 2012; however, the edits were omitted from the Edit Manual.
- Fifty-eight edits were on the FY 2012 listing of active edits and had no exceptions during FY 2012; however, the edits were omitted from the Edit Manual.
- One edit number was incorrectly listed in the Edit Manual due to a typographical error, and the documentation was not corrected.

We sampled five audits and seven edits reporting no failed claims for the current fiscal year. Three of the five audits sampled, or 60 percent, failed the test criteria. Specifically,

- One audit had a defect identified when DMS tested its functionality.
- Two audits were identified as active by DMS; however, when DMS attempted to test the audit, it was determined the audits are not applicable or could not generate an exception due to other audits activated earlier in the review process.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-08: The Cabinet For Health And Family Services' Department For Medicaid Services Did Not Ensure All System Audits And Edits Are Accurately Configured For The Kentucky Medicaid Management Information System And Up-To-Date Documentation Was Retained (Continued)

Of the seven sampled edits, four edits, or 57.1 percent, failed the test criteria. Specifically,

- Two edits had defects identified when DMS tested their functionality.
- Two edits were identified as active by DMS; however, when DMS attempted to test the edit, it was determined the edits were not applicable or could not generate an exception due to other edits activated earlier in the review process.

We are aware DMS has submitted a request to the vendor to update the documents to address these concerns. Further, the issues involving the audits and edits specifically identified as not performing as expected have been submitted to the vendor as defects for correction.

Failure to accurately document system audits and edits increased the risk that agency staff will be unfamiliar with audit and edit criteria. In addition, outdated documentation could also be a reflection of inaccuracies within the KYMMIS audit or edit configurations, which could lead to erroneous claims being processed or valid claims being denied. Inaccurate audit or edit configurations could allow excessive, inaccurate, or non-compliant claims to be processed.

Updated documentation of all system audits and edits should be retained for quality assurance purposes. Documentation should be distributed to all responsible personnel. In addition, all system audits and edits should be configured according to the agreed upon and approved criteria.

Recommendation

We recommend DMS work with the vendor to correct all audits and edits identified as defects. Additionally, DMS should work with the vendor to research any audits and edits where questions remain regarding the appropriateness of the logic or whether an audit or edit was active. Further, DMS should institute periodic reviews of active audits and edits to ensure they are accurately configured to flag claims matching the documented criteria. Any audits or edits identified as being configured incorrectly should be modified to ensure they function as required for business purposes. Documentation of this process should be maintained for audit purposes.

Finally, we recommend DMS continue to work with the vendor to update the KYMMIS audit and edit manuals. Any active audits and edits omitted from the associated documentation should be added along with the associated descriptions and criteria. With regard to inactive audits and edits, a notation should be made in the documentation to reflect an inactive status. DMS should also ensure all audit and edit numbers are recorded correctly in the documentation. Once updated, the audit and edit manuals should be distributed to all responsible personnel.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-08: The Cabinet For Health And Family Services' Department For Medicaid Services Did Not Ensure All System Audits And Edits Are Accurately Configured For The Kentucky Medicaid Management Information System And Up-To-Date Documentation Was Retained (Continued)

Management's Response and Corrective Action Plan

Response: In response to these findings, DMS has appointed staff to work/monitor these issues:

- *Implement a process for tracking and analyzing current system logic and applicable program policy compared to current documentation which will increase DMS ability to identify noncompliance. DMS will develop a process with a 10/1/2012 completing and initiating implementation of that process.*
- *Work with vendor and appropriate programmatic DMS staff to correct defects and perform updates, when necessary, as identified during the initial and subsequent reviews. This is an ongoing process, but DMS will commit to a date of July 1, 2014 to complete its initial review and correction of MMIS edits and audits.*
- *Implement a process for tracking any defect or change orders initiated as a result of review to ensure completion; this process will be developed by 10/1/2012.*
- *Take a proactive approach to documentation maintenance by implementing a process for monitoring systematic and/or programmatic changes which may impact the functionality of applicable audits/edits; more rigorous enforcement of current procedures involving the update of system documentation will begin by July 1, 2012.*
- *Work with vendor to modify the current structure of audit/edit manuals to include notation for inactive or end dated status and the inactive or end dated date. Modifications to the structure of the manuals has already begun. All new edits and audits will contain this information, and modification of all edit and audit documentation will be complete by November 30, 2013.*

DMS has begun work on creating a database to track and review current system logic compared to current documentation. Once complete, this phase will aid in identifying appropriate program policy staff who will review both system logic and documentation. Policy staff review will ensure the functionality is in accordance to current program policy; reporting any inaccuracies found in the functionality or documentation to project lead. In addition, this phase will aid in identifying inconsistencies with system logic compared to current documentation. The mission is to have accuracy and consistency among system logic, program policy (where applicable) and documentation.

During the initial and subsequent reviews DMS will work with vendor to ensure the most current manuals are electronically available to users. As defects or updates are identified, necessary defect or change orders will be submitted instructing the vendor on necessary changes or updates.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-CHFS-08: The Cabinet For Health And Family Services' Department For Medicaid Services Did Not Ensure All System Audits And Edits Are Accurately Configured For The Kentucky Medicaid Management Information System And Up-To-Date Documentation Was Retained (Continued)

DMS will immediately begin work on creating a process for tracking defect and change orders initiated as a result of review findings.

DMS will immediately begin discussion with the vendor to modify the current structure of audit/edit manuals to include notation for inactive or end dated status and the inactive or end dated date. This feature will aid in users easily and clearly identifying the appropriateness of audit/edit.

These efforts are in addition to last year's efforts, which included:

The Department for Medicaid Services (DMS) opened a non-billable Change Order on April 14, 2011 with the KYMMIS vendor to address this issue. This will be an ongoing effort with the vendor until all discrepancies are resolved. DMS' approach is to:

- *Request edit or audit pages policy staff suspect or know currently aren't correct*
- *Review the edit and audit pages*
- *Identify what is not current within the pages in the manual according to DMS policy*
- *Communicate what has been identified to the appropriate party to update/correct*
- *Update/correct the pages*
- *Add status (active/inactive) to the header of the manual pages*
- *Send the page(s) back to DMS staff for final review and sign off*
- *Work with the vendor to maintain a process to ensure the pages remain up to date ongoing within the documentation*
- *Test edits/audits that are not hitting any claims*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DOC-09: The Kentucky Department Of Corrections Did Not Ensure Sufficient Authentication Is Required to Access Potentially Sensitive Information

During our fiscal year (FY) 2012 security vulnerability assessment on Kentucky Department of Corrections (DOC) machines, instances were discovered where no authentication was required to allow an outside user to gain access either to information about the machine or to the service running on a designated port. We determined 19 of 52 scanned machines, or approximately 36.5 percent of the population, did not have sufficient authentication. Thirteen machines allowed access to document images maintained on the machine. In addition, default credentials allowed anonymous access to three machines.

During testing, we informed the agency of one machine that allowed administrative level access to an anonymous user through default credentials. This access would allow a user to configure settings, such as passwords. We would like to acknowledge that DOC secured this machine prior to the end of fieldwork.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

If a machine is allowed to provide excessive information associated with the machine to an anonymous user, then an intruder could potentially use this information to attempt to gain access to the machine or network or view documents that are confidential or sensitive.

Only necessary and required users should have access to services, particularly those services containing potentially sensitive information. Even if sensitive information is not present on the noted machines, gaining access to one machine on a network could allow additional network machines containing sensitive information to be compromised.

Recommendation

We recommend DOC ensure all services on network machines are restricted to only those users with a specific, business related need. Public or anonymous users should not be allowed access. As any new devices are placed on the network, they should be reviewed for open ports and services which may provide default access to public or anonymous users. Unnecessary services should be disabled. For business-related services, authentication should be configured and only users who have a specific business need for services should be granted access.

Due to this occurrence on multiple printer devices at DOC, we further recommend the agency review all printer devices to ensure that appropriate authentication has been established to the document images maintained on the devices.

Management's Response and Corrective Action Plan

The IT Branch has completed repairs to the issues found by the Auditor's Office.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-10: Department for Workforce Investment Closing Package Balances Were Not Accurate And Were Not Filed With The Finance And Administration Cabinet In A Timely Manner

The Department of Workforce Investment (DWI) submitted the closing package forms for accounts receivable and accounts payable to the Finance Administration Cabinet (FAC) without adequate review for completeness and correctness. The accounts receivable and accounts payable balances in the closing packages were understated. The information had to be corrected and subsequently had to be re-submitted to FAC. We noted the following issues related to the preparation of the agency's closing package;

- The UI Benefit accounts receivable due from other States was under reported by \$1,274,531. This was due to errors made during the compilation of the closing package. DWI made adjustments after auditor's notification.
- The UI account receivables and accounts payables are year-end processes. DWI uses the IB-6 icons system to record and report transactions. However, we noted the IB-6 Icon system was limited to quarterly basis reporting which did not accumulate previous information. In other words, the accounts receivable/accounts payable data did not carryover from quarter to quarter. As a result, the June 30th closing package did not include balances from three states totaling \$704,444. DWI made adjustments upon notification by the auditor.
- Incorrect figures were used to calculate the rate used to determine the Allowance for Uncollectible, understating the balance by \$483,091. Additionally, the UI Tax Estimated Amount to be refunded was also understated by \$1,075,598. This was due to an error during the compilation of the closing package. The agency amended the closing package and resubmitted after auditor's recommendation.
- The auditor further noted the agency initially omitted a check register amount of \$849,228 from the access data program, which generated the accounts payable balance. The agency discovered the check register but was unsure whether the check register should have been reported in the FY 2012. The check register was all old year money and needed to be part of the FY 2012 accounts payable balance.
- The deadline for DWI to submit the closing packages to FAC was August 24, 2012; however, the final closing packages were not submitted until November 13, 2012, after a 3rd amendment for accounts receivable and one for accounts payable. We are aware of the complexity and high work volume activities of DWI; however, we believe DWI has the capability and the resources to submit the closing package on time.

DWI did not ensure the submitted closing packages were complete with all appropriate information, properly accounted for, adequately reviewed for completeness, and submitted to FAC in a timely manner. This constitutes an internal control weakness. DWI handles over one billion dollars of UI transactions per year, and the failure to submit accurate accounts receivable and accounts payable information could lead to inaccurate closing package amounts while potentially understating or overstating the financial statements reported in CAFR.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-10: Department for Workforce Investment Closing Package Balances Were Not Accurate And Were Not Filed With The Finance And Administration Cabinet In A Timely Manner (Continued)

The methods used to determine the allowance for uncollectible balance, the estimated tax to be refunded and UI benefit accounts payable were inconsistent compared to prior fiscal years. The absence of a consistent reporting approach to determine the values above may cause the amounts to be underestimated or overestimated. This will potentially undermine the financial reporting function.

The closing packages required significant corrections and were not submitted on time to FAC. These delays caused difficulty for the auditor to review the closing packages within the scheduled fieldwork deadline. This also creates problems for the Controller's office to be able to provide timely and materially correct information for financial reporting purposes for the CAFR.

Good internal controls over the closing package forms and activities dictate that adequate review procedures should be created to ensure that the closing packages contain verifiable and accurate data before submission. Financial data includes, but is not limited to, the proper establishment of adequate and consistent methods, and properly accounting for all transactions for completeness and accuracy assertions. In addition, proper internal controls dictate that all supporting financial data be reconciled and reported on timely manner.

Recommendation

The Department of Workforce Investments (DWI) management should continue to ensure that the closing packages are adequately reviewed and submitted to FAC in a timely fashion. In addition, DWI management should monitor/review at least on a quarterly basis, all activities and balances related the closing package components to ensure they are consistent, complete, and accurate.

Management's Response and Corrective Action Plan

The DWI management is undergoing a functional review of all activities, one of which is the closing package submission process. This review has identified several areas that management needs to ensure reports are reviewed and submitted timely to the appropriate entity. Staff within DWI will collaborate on efforts to ensure errors are identified and corrected prior to submission and that those submissions will be in adherence to established reporting deadlines.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-11: Department Of Workforce Investment Did Not Maintain Adequate Documentation For Supporting Expenditures

During the FY12 audit of the Department of Workforce Investments' expenditure testing, we noted transactions were missing several confirmations documents. Each transaction is required by agency policy and procedures to have specific documentation components. One of those specific documentation components is the confirmation component which shows the number of checks and dollar amount that Finance and Administration has approved for Treasury to pay. The confirmation component was missing from 14 of the 90 transactions that the auditor reviewed. This internal control procedure was designed to provide audit trails, which further enhance transparency and improve effective internal control.

DWI did not ensure that all adequate supporting documents for recording expenditures were maintained as required by the Agency's policies and procedures. Insufficient maintenance of supporting documentation of expenditures leads to violation of the management assertions of completeness, and non compliance with the agency's internal policies and procedures.

The AICPA auditing standards (AICPA Codification AU Section 326.01) require the auditor to obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit. Additionally, proper internal control dictates that adequate/sufficient supporting documentation for all transactions is maintained to verify management assertions of existence and completion of transactions. Adherence to these policy and procedures increases audit trails and effective internal controls.

Recommendation

We recommend the Department of Workforce Investments (DWI) management continues to ensure that adequate supporting documentation for recording UI expenditure transactions are complete. These enhance good audit trails and effective internal control and financial reporting.

Management's Response and Corrective Action Plan

DWI management has located and identified for APA staff the majority of the 14 missing confirmations. The 6 missing confirmations were due to Finance's staff member's work schedule. This is being discussed with Finance to ensure daily confirmations are received. Further, the process included manually printing of confirmations and placing them in the file. Starting July 1, 2012 the documents are being maintained electronically to ensure confirmation of UI expenditure transactions.

Auditor's Reply

As indicated in DWI's response, six confirmations still remain missing, and were not provided and included in the documentation file, which violates the agency's policy. We recognize DWI's management effort to adhere to proper internal controls; however, we reiterate our recommendation that adequate supporting documentation be maintained for all expenditure transactions.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-12: Department for Workforce Investment Written Policies/Procedures For The Unemployment Insurance Trust Fund Were Not Upgraded With Current Practice

Each year the Office of Unemployment Insurance (UI) handles over \$1 billion in state and federal funds flowing through funds 6210 and 6200. All financial data reports are agreed to the Tax Cash Book and related bank account, the Benefits Cash Book and the related bank account, various eMARS reports, and the Trust Fund Account. The monthly reconciliation is performed by the Trust Fund Officer. All UI financial data is reportable monthly and quarterly via various UI grant reports.

The UI Trust Fund Office has a written procedures manual that covers various UI processes, including the reconciliation of accounts. The process is very complex. The procedures manual as of June 2012 does not encompass all aspects of the process. There have been numerous changes that are not covered by the manual. Those changes include items such as:

- Major upgrades to the state's accounting system (eMARS) in May 2008 and April 2012,
- Procedural changes required for July 2011 when the state's banking switched from Farmer's Bank to Chase Bank,
- The Reed Act expired several years ago. The funds associated with the Reed Act were received, expended, and reported on several years ago. A Reed Act report for Reed Act transactions is no longer applicable. The report was still noted in the policies and procedures manual as recently as June 2012.

Furthermore, the auditor determined that the written policies and procedures for the Unemployment Trust Office, including procedures for day to day activities and monthly activities, have not been updated for several years. Our review of the procedures manual showed the last update addressed "bomb threat procedures" in 2009, while all other aspects were updated last in 2007.

The lack of comprehensive and updated policies and procedures for the UI Trust Office creates operational risks, such as the omission of necessary steps that should be performed, timeliness for performing steps completely and accurately, or how to handle unresolved issues. Additionally, there are compliance risks, such as the completion of required reports, and risks that the UI financial processes could be adversely impacted, such as funds transfers not being properly timed or properly handled.

The written policies and procedures should be detailed and address daily processing, monthly processing, quarterly processing, and annual processing. They should include written procedures covering monthly reconciliations, monthly reports, and all reports prepared for any segment of the Federal government. The policies and procedures should link the tasks to the cash book for benefits and the cash book for taxes.

Written policies and procedures help prevent mistakes, ensure compliance, save time, provide staff training, ensure consistency, improve quality and provide an accurate accounting of the funds.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-DWI-12: Department for Workforce Investment Written Policies/Procedures For The Unemployment Insurance Trust Fund Were Not Upgraded With Current Practice (Continued)**

Recommendation

We recommend the agency upgrade and maintain detailed written policies and procedures for the Unemployment Insurance Trust Fund. Periodically, management should conduct reviews to ensure personnel are adhering to written procedures. Also, periodic reviews and updates to the manual should be done to ensure accuracy of the policies and procedures.

Management's Response and Corrective Action Plan

The Office of Employment and Training (OET) agrees that written policies and procedures should be maintained for the operation of the Unemployment Insurance Trust Fund (UITF). Upon hiring of new staff in August 2012, one of the first responsibilities was to update the policy manual. It was noted in the update that major changes with internal procedures didn't change with the (eMARS) upgrade, but new screen shots have been included in the manual to be current. The change in the state's banking also didn't require major internal procedure changes, but the manual has been updated to include the most current banking screen shots. In addition, ongoing efforts are being undertaken to utilize the additional functionality of the state's new bank.

Reed Act money was consolidated into the UI account balances effective 10/1/2007. The Federal reporting system has not changed and will continue to contain Reed Act balances by year. In addition the Federal instructions still include an ETA8403 report and the manual will maintain our internal procedures until guidance from the Federal government changes.

Even though the physical appearance of documents may have changed with (eMARS) upgrades and change in State's bank, the procedures to process those documents were not changed in a drastic manner that would jeopardize the operations of the (UITF).

OET management agrees that procedures should be reviewed periodically and will do so on a continuous basis.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-13: The Office Of Employment And Training Did Not Develop Formal System Documentation To Support Processing Performed By The Workforce Investment Act Online Reporting Of Kentucky System

As noted during the prior two audits, our fiscal year (FY) 2012 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed OET did not maintain basic documentation of the overall functionality or specific processing of the WORK system.

The WORK system was based on a vendor-developed application customized for the Commonwealth of Kentucky. It was designed to manage the process of initiating, reviewing, and awarding grant monies offered by the State Pass-Through Entity for WIA, the Department of Workforce Investment (DWI), to the Local Workforce Investment Area (LWIA) offices. WORK also manages the processes of reimbursement, financial reporting, and progress reporting. The original contract with the application vendor required a user manual to be created for use at the LWIAs and training be provided for the central level staff. The vendor did not provide specific user or technical manuals to OET for use by the central level staff. Further, no user or technical documentation was developed and finalized internally at OET for central level staff. OET did draft a manual for central level staff; however, the draft manual is limited in scope and does not cover administrative or other grant or reporting functions for central level staff.

We are aware OET has continued its contract with the vendor and anticipates implementing an upgrade to the WORK system by June 30, 2012.

Lack of documentation increases the likelihood of erroneous or incomplete processing. It further increases the likelihood of unauthorized data modification, destruction of assets, and interruption of services.

Proper documentation should be maintained for each critical system in production to, at a minimum, identify the purpose of the system, what procedures can be performed within the system, how the system will interact with other systems, and what output of data or reports are anticipated.

Recommendation

As the upgrade to the WORK system is anticipated by June 30, 2012, we recommend OET work with the application vendor to develop a manual of the specific functionality available within the WORK system upgrade. This document should specifically cover the overall functionality of the system, the administration of the system, and the processing of transactions at the central and LWIA levels.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-DWI-13: The Office Of Employment And Training Did Not Develop Formal System Documentation To Support Processing Performed By The Workforce Investment Act Online Reporting Of Kentucky System (Continued)**

Management's Response and Corrective Action Plan

The WORK System data conversion from the old system to the new is estimated to be completed by the end of September 2012. Additional reporting and other enhancements will be implemented upon agreement of a new Statement of Work and approval from the Finance Cabinet to proceed. The additional work is estimated to begin in October 2012.

Manuals have been drafted and will be finalized at the time the system is put in production. DTS Security will continue to work with OET and the software vendor to implement policies and procedures regarding the WORK system.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-14: The Office Of Employment And Training Did Not Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System

As noted during the prior two audits, our fiscal year (FY) 2012 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed the informal administrative logical security controls over the WORK system were lax. This lack of formal documentation of controls for the system allowed a situation where staff was provided excessive rights based on current job duties and a lack of understanding of the requirements for administering the system.

Six levels of access were allowed to the WORK system. Three of these levels were explicitly defined within the vendor-created Grantee Help Manual and are being used by staff at the Local Workforce Investment Area (LWIA) offices. The remaining three levels of access are being used by central level Department of Workforce Investment (DWI) staff; however, there is no documentation of the exact functionality established for each of these central access levels. The auditor was able to determine from discussion with staff and inference of functional characteristics within the Grantee Help Manual, that these three central access levels allow administration of user accounts, development of allocation for grants, and approval of applications from LWIAs for grant funding. The only specific difference identified by OET management between these access levels is one access level has the ability to create a new grant within WORK. Therefore, all central level staff members, no matter their individual job duties within the system, were provided both administrative and operational functionality, which creates a segregation of duties issue.

Currently, there is no access level established within the system that would allow "read" only access to data and reports. If someone needs information from WORK and does not have access, an authorized WORK user will publish reports for the individual.

The Grantee Help Manual, which is provided to LWIA staff for processing at the LWIA level within the WORK system, specifies the process to be followed by LWIA staff to request, delete, or change access for users. According to Section 1.1.6 of the Grantee Help Manual, DWI requires that the Chief Executive Officer of a LWIA write a letter to the DWI Budget and Support Branch Manager requesting access for each member of the LWIA who will be accessing WORK. This process was followed when WORK was first implemented; however, this has since been changed. Currently, requests for new access, deletion, or changes in status require a written request from either the LWIA Fiscal Officer or Authorized Signatory. A written request, usually in the form of an email, is the only requirement for Level 2 (LWIA Staff Member) or Level 4 (Fiscal Officer) access. A Level 5 (Authorized Signature) access request requires both a written request and a signed OET Authorized Signature Form. A Level 6 (Program Staff), Level 6b (OET Management), or Level 6c (Executive Signatory) access request requires a signed WORK System Access Request Form.

We examined supporting documentation for 12 new user accounts to determine compliance with the established informal procedures currently in use for granting access. Our examination revealed one user, or approximately 8.3 percent, was granted a different level of access than requested on the WORK System Access Request Form.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-14: The Office Of Employment And Training Did Not Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)

It was determined in the previous three audits that users had been established with both Fiscal Officer and Authorized Signatory rights at the LWIAs. Due to staffing resources at some LWIAs, OET management decided to allow this dual function for users if the LWIA Director provided approval through a formal request for the access. During the prior year audit, OET management confirmed with each LWIA Director that all current users with the dual access required it to perform their job duties.

We are aware OET has continued its contract with the vendor and anticipates implementing an upgrade to the WORK system by June 30, 2012.

Failure to develop and implement administrative logical security controls could lead to a lack of understanding by management and users of specific roles and responsibilities, which could result in a failure to comply with security policies, a failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. If the developed controls are not sufficiently strong, this situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, and inappropriate or illegal use of system resources.

The foundation of logical security is access control, which refers to how system access is determined and granted to users. Formal policies provide a security framework to educate management and users of their security responsibilities. Consistent application of formalized security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls. Further, the level of system access granted to users should be restricted to only areas necessary for an employee to perform assigned job duties.

Recommendation

As the upgrade to the WORK system is anticipated by June 30, 2012, we recommend OET work with the vendor to create, formalize, and implement a WORK security manual specific to the upgraded system. This manual should, at a minimum, specifically cover all access levels available in the system; the process for requesting access to the system; the process for establishing, altering, revoking, and deleting access to the system for users; and appropriate use guidelines for all users. Further, all available access levels should be identified and associated access rights for each level should be explicitly described. Using this information, OET should ensure that all access requests are completed as requested. Any variations from the requested access should be documented and approved by management.

We also recommend the Grantee Help Manual be updated to reflect the current access request process for LWIA staff. Further, for those LWIA staff provided both Level 4 (Fiscal Officer) and Level 5 (Authorized Signatory) access, OET should document the required authorization process to receive both types of access. OET should define an alternative procedure for approval for those instances where the staff requiring the Fiscal Officer and Authorized Signatory access is the LWIA Director.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-14: The Office Of Employment And Training Did Not Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)

Recommendation (Continued)

Once the WORK security manual is developed and the Grantee Help Manual is updated, these documents should be provided to all appropriate staff. The documented processes in these manuals should be consistently applied to all new users or additional levels of access, and any applicable access request forms should be accurately completed and maintained for all users.

We recommend OET work with the application vendor to determine whether a security access level will be available within the upgrade which would allow read only access to the system. If this type of access is not available, OET should consider working with the vendor to establish this level of access.

In anticipation of the upgraded system:

- OET should create a listing of all currently active users in the individual LWIAs to be reviewed and validated for appropriateness.
- OET should review the currently active central level staff to ensure access is still necessary.
- Any user accounts identified as no longer necessary should be changed to inactive status.
- OET should specifically identify the functionality needed within the system for each central level staff. Using this information, functional groups should be identified, such as administration, grant review, and allocation. These functional groups should be provided as defined access levels to the vendor for inclusion in the new system.

Management's Response and Corrective Action Plan

The WORK System data conversion from the old system to the new is estimated to be completed by the end of September 2012. Additional reporting and other enhancements will be implemented upon agreement of a new Statement of Work and approval from the Finance Cabinet to proceed. The additional work is estimated to begin in October 2012.

DTS will continue to work with OET and the software vendor to implement procedures for granting access to the new version. This will include written documentation on the procedures for granting access, new request forms and password structure procedures. There is currently a draft of this manual in progress that requires modifications before release.

OET is working with the vendor to create, formalize and implement a WORK security manual specific to the upgraded system. This manual will specifically cover all access levels available in the system; the process for requesting access to the system; the process for establishing, altering, revoking and deleting access to the system for users; and appropriate use guidelines for all users. Further, all available access levels will be identified and associated access rights for each level will be explicitly described.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-DWI-14: The Office Of Employment And Training Did Not Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)**

Management's Response and Corrective Action Plan (Continued)

OET will update the Grantee Help Manual to reflect the current access request process for LWIA staff. Further, for those LWIA staff provided both Level 4 (Fiscal Officer) and Level 5 (Authorized Signatory) access, OET will document the required authorization process to receive both types of access. OET will define an alternative procedure for approval for those instances where the staff requiring the Fiscal Officer and Authorized Signatory access is the LWIA Director.

Once the WORK security manual is developed and the Grantee Help Manual is updated, these documents will be provided to all appropriate staff. The documented processes in these manuals will be consistently applied to all new users or additional levels of access, and any applicable access request forms will be completed and maintained for all users.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-15: The Office Of Employment And Training Did Not Ensure Programmatic Logical Security Controls Were Properly Designed And Configured

As noted during the prior two audits, our fiscal year (FY) 2012 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed programmatic logical security controls were not designed or properly configured to ensure only authorized users interact with the system.

User accounts can be established by users granted one of three central access levels. When a new user account is created, the user is provided a user name and initial password. The password must be changed by the user upon first login. The criteria established for the syntax of a valid password are very minimal:

- Password must be at 7-12 characters in length.
- Password must not be "password."
- The same password may not be used twice in a row.

However, there is no password lockout threshold and passwords do not expire.

Additionally, OET staff is unaware of a function within the WORK system that would allow the password for a current user account to be reset. According to OET, if a user is unable to remember his or her password, then an authorized member of OET may either create a new account for the user or look up the current account's password. It was determined the password is shown in clear text within the source code of the user information screen in the WORK system.

Finally, it was noted that user accounts within the WORK system are numeric and issued sequentially. There were five active user accounts identified during review of user accounts within the system that did not follow this anticipated syntax.

We are aware OET has continued its contract with the vendor and anticipates implementing an upgrade to the WORK system by June 30, 2012.

The existence of non-expiring passwords, the lack of a lockout threshold, and the sequentially numbered user names increase the risk that an unauthorized user could attempt to access the system and would not be identified. A password cracking tool could be run against a known user account without causing a disruption in service to the user, since the account would never be locked out, even if a large number of incorrect passwords were attempted. Since the tendency of most users with non-expiring passwords is to keep the same password indefinitely, a potential intruder has the advantage of an unlimited amount of time to work with an account to determine the correct password.

Further, the fact that passwords are viewable in clear text increases the risk a current user of the system with access to this information might impersonate another valid user. Because a legitimate user account name and password would be used, there would be no direct indication of inappropriate use.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-15: The Office Of Employment And Training Did Not Ensure Programmatic Logical Security Controls Were Properly Designed And Configured (Continued)

The Commonwealth Office of Technology (COT) has issued an Enterprise Policy related to logical security controls over user accounts and passwords, CIO-072, UserID and Password Policy. This policy was originally established in 2002 and most recently updated in May 2007. Within this policy, COT establishes specific expectations for user IDs and password controls.

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Passwords must be:

- Kept confidential;
- Changed at least every 31 days unless otherwise approved (non-expiring passwords must be approved on an exception basis);
- Changed whenever there is a chance that the password or the system could be compromised;
- Encrypted when held in storage or when transmitted across the network when the path is connected to an external network.

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Passwords must:

- Be eight (8) or more characters;
- Contain uppercase letter(s);
- Contain lowercase letter(s);
- Contain a number;
- Contain a special character.

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Password History

Individuals must not reuse previously used passwords. To prevent this, a password history of 12 or more previous passwords must be kept.

Password Change

Passwords must be changed by the user at least every 31 days. If inadvertent disclosure is known or suspected, the passwords must be changed immediately. NOTE: In the event misuse is suspected, do NOT change the password; IMMEDIATELY notify the System/Network Administrator and/or the agency's security office. A security incident must be documented. Subsequent password change shall be made by the System/Network Administrator's and/or agency's security office direction only.

Minimum Password Age

Where supported, the minimum password age must be set to one day. This will help prevent users from "cycling" through passwords, thus bypassing the password history list. However, if inadvertent disclosure is known or suspected, the password must be changed immediately. In such instances, notify the systems administrator immediately.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-DWI-15: The Office Of Employment And Training Did Not Ensure Programmatic Logical Security Controls Were Properly Designed And Configured (Continued)

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Password and UserID Lockout

To prevent individuals from attempting to log-in with UserIDs by guessing passwords, accounts will be locked after three (3) consecutive invalid log-in attempts. Password resets must follow the policy stated herein for password length/composition.

Further, it is good business practice to develop a system that would allow a password to be reset if there is a situation in which a user has forgotten his or her password. This control should be maintained at an appropriately high level of management and requests for password resets should be documented and maintained for review.

Recommendation

As the upgrade to the WORK system is anticipated by June 30, 2012, we recommend OET work with the application vendor to alter any necessary password control configurations within the upgraded system to comply with the CIO-072, UserID and Password Policy. These control configurations should include, at a minimum:

- Passwords should be at least 8 characters.
- Passwords should contain at least one upper case letter, lower case letter, number, and special character.
- Passwords should be changed every 31 days.
- Passwords should have a minimum age value of 1 day.
- A password history of the last 12 passwords should be maintained.
- Accounts should be locked out of the application after three consecutive invalid log-in attempts.

OET should request the application vendor to restrict access to the underlying source code of the user information page in the upgraded system, if possible. If that is not possible, the password information should be removed from the source code and stored only in an encrypted format to be used within the password validation process.

Further, OET should work with the application vendor to determine if a password reset function will be available within the upgraded system. If so, this process should be formally documented, distributed to all appropriate staff, and immediately implemented. If this functionality is not available, OET should work with the vendor to determine the feasibility of adding this function to the upgraded system.

Finally, OET should consider implementing a new username syntax that is more complex than currently in place. Once established, the syntax should be consistently applied to all new users established within the system.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-DWI-15: The Office Of Employment And Training Did Not Ensure Programmatic Logical Security Controls Were Properly Designed And Configured (Continued)**

Management's Response and Corrective Action Plan

With the implementation of the new program, all password concerns will be addressed. The WORK System data conversion from the old system to the new is estimated to be completed by the end of September 2012. The additional work is estimated to begin in October 2012.

OET and DWI Security Staff are working with the application vendor to alter any necessary password control configurations within the upgrade system to comply with the CIO-072, UserID and Password Policy. These control configurations will be implemented at a minimum:

- *Passwords will be at least 8 characters.*
- *Passwords will contain at least one upper case letter, lower case letter, number and special character.*
- *Password will be changed every 30 days.*
- *Passwords will have a minimum age value of 1 day.*
- *A password history of the last 12 passwords will be maintained.*
- *Accounts will be locked out of the application after three consecutive invalid log-in attempts.*

OET will request the application vendor to restrict access to the underlying source code of the user information page in the upgraded system.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-16: The Finance And Administration Cabinet Did Not Ensure Available Information Within infoAdvantage Universes Was Complete To Allow Accurate Reporting

As noted in the past five audits, our fiscal year (FY) 2012 audit of the Finance and Administration Cabinet (Finance) revealed infoAdvantage, the reporting solution used in conjunction with the enhanced Management Administrative and Reporting System (eMARS), could not be fully relied upon to provide the user with complete and accurate data. During the audit, we found instances where reporting was not functioning properly.

We identified three instances where a data field related to a document was not available within the associated universe, but was either explicitly required or prohibited by the Document Control (DCTRL) table and available for use on the online version of the document.

- We noted that the “Customer” field is prohibited for the Solicitation Response (SR) and Solicitation Response Wizard (SRW) documents, based on the DCTRL table; however, there is not a “Vendor/Customer Code” within the SR class or linked to the document codes within the Procurement Awards Universe. This field is available to be populated when the document is developed, due to the fact that a “Vendor” code is allowable. When a user develops a report of SR or SRW documents from the infoAdvantage Procurement Awards universe including this field, the values for the “Vendor/Customer Code” are coming from the Award Accounting Line. However, there is not a direct relationship between the SR and the Award Accounting Line tables in the Procurement Awards universe. Therefore, the data values returned cannot be relied upon.
- We found that the “Cited Authority” field is required for the Contract (CT), Contract 2-Way Match (CT2), Contract KYTC (CTT1), Contract 2-Way Match KYTC (CTT2), Delivery Order (DO), Delivery Order 2-Way Match (DO2), General Accounting Expense/Expenditure (GAX), Purchase Order (PO), Purchase Order 2-Way Match (PO2), Proof of Necessity Agreement (PON2), Commodity Based Payment Requisition (PRC), and Commodity Based Internal Payment Requisition (PRCI) documents based on the DCTRL table; however, the “Cited Authority” field is not available in the Accounting Journal class or linked to the document codes within the General Accounting Universe. The field is available for use when these documents are developed.
- We noted there is no “Event Type” field available within the Accounts Payable - KY Universe; therefore, the auditor was not able to test for required or prohibited fields based on the Event Requirement (ERQ) table. Specifically, this issue affected the Check Writer Check Cancellation (CWC) document.

Additionally, we identified two instances where a data field related to a document is available within the anticipated universe, but the linking is not established to allow for reporting that will include the data field.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-16: The Finance And Administration Cabinet Did Not Ensure Available Information Within infoAdvantage Universes Was Complete To Allow Accurate Reporting (Continued)

- We identified instances where the “Event Type” field is available, but not linked to the Document Header within the Accounts Payable Universe. Without this linking to the “Event Type,” it is not possible for reporting to be developed to determine the appropriateness of coding for required and prohibited fields from the ERQ table on the Management Budget (OB1) or CWC, and General Accounting Intercept Payment (GAIP) documents.
- We determined the Vendor/Customer information was not linked to the Document Header within the Accounts Payable Universe. Without this linking, it is not possible to ensure edits related to Vendor/Customer fields were operating effectively. Specifically, the GAIP document was affected by this issue.

The lack of a data dictionary in conjunction with the inability of a normal end-user to see the underlying database links related to data elements increases the risk that a user will develop reports based on incorrect data elements, or inadvertently exclude data due to links that the user is unaware of when developing the report. Such reporting issues could cause the results to be inaccurate or incomplete.

For reports to be useful and valid for management decision-making purposes, the reporting solution used should be appropriately designed to allow users to view data and develop reports that are complete and accurate. A reporting solution must, therefore, be understandable by the end user in structure, content, and context. Further, the underlying structure of the data must be appropriate for the overall accounting regulations of the organization; otherwise, the solution may provide information that is not expected by the end user.

Recommendation

We recommend Finance continue work on the infoAdvantage reporting solution, in conjunction with the vendor, to ensure that all known reporting problems are corrected or properly addressed. Further, a review of the established links within the universes should be performed to ensure they are functioning as intended for the Commonwealth of Kentucky.

To further assist end user reporting capabilities, Finance should develop a data dictionary that is available to all users. This data dictionary should include information concerning:

- The originating table location of the data element;
- A description of the data element;
- A description of all pertinent joins involving the data element; and,
- A listing of other data elements that the data element is dependent upon for reporting purposes.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

FINDING 12-FAC-16: The Finance And Administration Cabinet Did Not Ensure Available Information Within infoAdvantage Universes Was Complete To Allow Accurate Reporting (Continued)

Management's Response and Corrective Action Plan

Finance continues to work with the vendor to address known reporting problems. The 3.9 upgrade to universes in infoAdvantage is still planned, and it is possible that some of the desired data elements will be made available in the upgraded universes. Given that this upgrade includes numerous universe changes, providing a data dictionary for 3.6 universes is not prudent at this time. Commonwealth and vendor resources will continue to work diligently together to configure infoAdvantage correctly throughout the 3.9 universe upgrade.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-17: The Finance And Administration Cabinet Did Not Properly Restrict Access Through Network Neighborhood

Based on a control weakness originally identified during the fiscal year (FY) 2009 audit of the Office of Financial Management (OFM) related to the ability to access a machine housing the Complete Asset Management, Reporting, and Accounting (CAMRA) application, it was determined that the Finance and Administration Cabinet (Finance) did not properly restrict access to machines on one of its domains. During the FY 2012 audit, a review of this Finance domain through Network Neighborhood revealed 229 out of 249 machines within the oversight responsibility of the Commonwealth Office of Technology (COT) allowed access without authentication of the requesting user. Of the 229 machines, 154 machines had files or folders that were visible. Also, the auditor was able to access sub-folders within 72 machines. Of the 72 machines housing sub-folders, 71 machines contained files or documents which the auditor could view. The information found on the accessible machines included, but was not limited to, messaging logs, reports, manuals, drivers, and software configuration and executable files.

Of the 71 machines containing accessible files or documents, the machine housing the CAMRA application contained files that provided bank account information. We also noted a machine that housed data for the Department of Corrections (DOC), which contained approved visitor listings per correctional facility by inmate and visitor name. These listings consisted of the visitor's name, age, date of birth, relationship, address, and any special conditions. Additionally, we identified a machine housing Kentucky Transportation Cabinet (KYTC) data, which maintained copies of commercial vehicle tax documents. These documents provided vehicle ownership, license, and serial number information. We also discovered social security numbers within a motor vehicle dealer listing and Public Protection Cabinet (PPC) state professional board membership listings on another machine. These instances were immediately reported to Finance and COT during audit fieldwork.

For security purposes, detailed information concerning the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Sensitive information that is placed in a shared file can be obtained by unauthorized users if not properly secured. Further, if a machine is not configured to properly restrict access, then an intruder could potentially use this available resource to attempt to gain access to the network.

Security policies should be in place to address adequately securing files on local workstations. Access to an agency's domain machines should be restricted to only users requiring access related to a valid business purpose. All access should be appropriately restricted.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-FAC-17: The Finance And Administration Cabinet Did Not Properly Restrict Access Through Network Neighborhood (Continued)**

Recommendation

We recommend Finance work with COT to review all machines within the domain discussed above to ensure resources are adequately secured and policies are implemented to address this issue. Security on all network machines should be configured to properly restrict access, unless a valid business purpose is determined and specifically documented. Periodic reviews of domain machines should be performed to ensure only proper access is allowed. We recommend COT provide sufficient training to appropriate agency staff to ensure they are aware of the risk this issue poses and that they fully understand the steps to take to ensure this information is properly secured.

Management's Response and Corrective Action Plan

COT is currently reviewing the detail documentation provided by APA. COT will document in detail any specific business needs, mitigating controls, or actions taken to remediate the individual items in the finding detail. The review is expected to be completed by October 31, 2012 due to the number of systems requiring review. Upon completion, the resulting documentation will be provided to APA. In addition, for any items that require action to correct, efforts will be made to work with the areas of responsibility to establish procedures that will ensure that appropriate permissions are applied at the time of creation.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-18: The Finance And Administration Cabinet Did Not Develop And Implement A Formal Policy To Govern Security Of The eMARS Checkwriter Interface Process

As noted during the previous five audits, the Finance and Administration Cabinet (Finance) has yet to develop or implement a formal policy identifying specific responsibilities of those individuals involved with the Enhanced Management Administrative and Reporting System (eMARS) Checkwriter (CW) interface process. The Finance Statewide Accounting Services (SAS) is ultimately responsible for the processing of CW files. Further, SAS is responsible for ensuring access to CW files is reasonable. SAS should ensure a proper segregation of duties exists between the creator of the CW file and the person certifying the file for processing and check generation through eMARS. These duties are established through the use of eMARS security roles and a manual review process performed by SAS during the central level certification. We are aware that Finance began drafting a formal policy during audit fieldwork.

Our examination of the CW certification process revealed one CW file where the individual who loaded and certified at the department level was the same user. No documentation was on file with SAS authorizing this individual to perform both actions. For proper segregation of duties, management should have provided formal approval prior to these actions being taken.

Allowing users the ability to both create CW files and certify those files for processing and check generation increases the likelihood of unauthorized payments and may compromise the integrity of data processed through the system. A lack of formalized policy and procedures concerning the CW file access and processes can lead to inconsistent understandings between the agency, management, and users.

Formally implemented policies and procedures concerning CW access and established processes are necessary to allow both management and users to have a clear understanding of respective responsibilities. These controls are imperative to ensure the reasonableness of individual access as it relates to CW files and proper segregation of duties when processing CW files.

Recommendation

We recommend Finance establish formal policies and procedures to govern the security surrounding CW interface access and the submission and certification processes. This effort should include standardized procedures to ensure proper segregation of duties at the agency and central levels between the individuals creating and uploading the CW file and those individuals placing the certification on the CW file. This policy should explain the responsibilities associated with each of the CW interface security roles and discuss the need to assign these roles to different individuals, where possible, to ensure proper segregation of duties.

In the event that the same user is required to load and department certify a CW file, the formalized CW interface security policy should require the department head or designee to request prior approval from SAS. Further, if the central level certifier determines that a CW file has already been loaded and certified by the same user, SAS should elicit justification for these actions from the department. SAS should document the request and associated approval or refusal.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-18: The Finance And Administration Cabinet Did Not Develop And Implement A Formal Policy To Govern Security Of The eMARS Checkwriter Interface Process (Continued)

Management's Response and Corrective Action Plan

A Policy has been drafted. This governs the security surrounding the checkwriter interface process. It summarized the responsibilities of each party involved with the processing of the CW file.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-19: The Finance And Administration Cabinet Did Not Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases

Our fiscal year (FY) 2012 audit of the Finance and Administration Cabinet (Finance) revealed that informal logical security procedures existed for granting access to the Enhanced Management Administrative and Reporting System (eMARS) production databases and for establishing non-expiring passwords for specific types of accounts. However, these procedures were not written or consistently applied. This situation was also noted during the previous four audits.

In order to request access to the eMARS production databases, a COT-F181 form must be completed, authorized electronically, and emailed to the Commonwealth Service Desk for processing within the Commonwealth Office of Technology (COT) service tracking application. Of the nine new individual users with access to the eMARS production databases, the auditor noted two users had a supporting COT-F181 form and service ticket on file; however, the service ticket omitted an approval identifying that the request was completed.

Additionally, five instances were identified where accounts were active on one or more databases for employees who were no longer employed by the state or associated agencies. Specifically, all five users had access to the infoAdvantage database, two of which also had access to the Finance and Administration database. As a result of the inquiry into these accounts, Finance requested the removal of database access for the above accounts. We also noted one of the five users retained an active eMARS application account despite no longer being employed by the eMARS vendor.

Further, two profiles on multiple databases had a profile setting regarding failed login attempts that did not comply with the CIO-072 COT Userid and Password Policy.

For security purposes, detailed information concerning the specific user accounts and profiles contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Failure to consistently apply logical security controls could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources. In addition, whenever electronic signatures are accepted forms of authorization, there should be another form of documentation on file, such as emails, to substantiate those signatures. The existence of unnecessary accounts is inviting to intruders and can lead to those accounts being utilized by unauthorized users.

Established security policies and procedures should be formally documented and consistently applied to provide continuity for policy implementation and set the tone of management concern for a strong system to secure assets and resources. Access should only be granted to approved users, and access should be removed promptly upon termination of employment or when said access is no longer required.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-FAC-19: The Finance And Administration Cabinet Did Not Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases (Continued)

Further, the Userid and Password Policy (CIO-072) states “[t]o prevent individuals from attempting to log-in with UserIDs by guessing passwords, accounts will be locked after three (3) consecutive invalid log-in attempts.”

Recommendation

We recommend Finance create written logical security procedures related to Oracle databases and consistently apply them to ensure only authorized access is granted to the ePayment Gateway, Finance and Administration, Vendor Self Service, and infoAdvantage production databases. These procedures should require the COT-F181 form to establish or change access for accounts and the COT-F085 forms to authorize a non-expiring password to be consistently used. Furthermore, emails authorizing these forms should be retained for audit purposes and authorization to support the access granted should be consistently retained in the COT tracking system. All documentation establishing a user’s access should be retained in a central repository for audit purposes. Further, the profile settings should be set to comply with the COT password policy.

Management’s Response and Corrective Action Plan

All databases identified in the detail findings are no longer in use with one exception. The remaining database has been configured to comply with the standards regarding failed login attempts. The accounts noted in the findings have been reviewed and any accounts that are no longer needed have been removed and appropriate documentation has been established for accounts that remain in use.

Steps have been taken to address the user account documentation concerns now and in the future. The F181 form has been modified to include detail concerning database access. This has been incorporated in the processes within the Data Management Branch to ensure that documentation is collected and retained for each account creation, deletion, and modification.

To address the configuration concerns going forward, COT is currently working towards a long term solution and has initiated a project to develop hardened baselines for new COT managed devices that connect to the Commonwealth network. This project is in the early planning phase and there is not a projected time of completion at this time. The project is expected to continue throughout the coming year.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-JUV-20: The Department Of Juvenile Justice Does Not Have A System In Place For Monitoring Its Facilities

We performed audit procedures at the Department of Juvenile Justice (DJJ), which included visiting various facilities to observe the financial controls over receipts and disbursements. We noted DJJ does not have a system in place for monitoring the financial controls at the youth development centers, group homes, day treatment centers, and detention centers. The lack of an internal monitoring function has created the opportunity for theft and/or errors to occur and remain undetected at these facilities.

The agency's mission is compromised when appropriate financial accounting controls are not in place. A lack of internal control, which includes policies and procedures and management oversight, increases the opportunity for fraud, waste, and/or abuse to occur and likelihood that it would remain undetected due to a lack of monitoring of the facilities. When policies are not specific, the facilities must develop their own policies for processing transactions.

Also, a lack of control or oversight at these facilities means that facilities must develop their own system of controls for processing transactions, thus there is no uniformity in how the facilities operate across the state.

Good internal controls dictate that the agency has a system in place for monitoring the financial activities and management of the youth development centers, group homes, day treatment centers, and detention centers. Monitoring controls are necessary for ensuring that funds received from DJJ are accounted for appropriately and spent for their intended purpose.

Recommendation

DJJ should develop and implement monitoring procedures for all of its facilities - youth development centers, group homes, day treatment centers, and detention centers. The monitoring system should include the establishment of policies and procedures applicable for all facilities and include all facets of program operations and financial activities. An effective monitoring system would also include documentation to support the review of facilities, conclusions reached, decisions made, approval of those by management, and reporting all activity to management. Further, communication of any findings and recommendations for improvement should be communicated to the monitored entity, as well as any follow-up on problems noted during any reviews.

Management's Response and Corrective Action Plan

In June of 2012, new personnel was designated as the Fiscal Branch Internal Auditor and given the responsibility of performing on site audits of all facilities and offices under the Department of Juvenile Justice. Prior financial audits were performed only on Youth Activity Accounts and other non-governmental funds. For FY 2013 a single in-depth audit will be performed at each facility and will include training for Fiscal Managers and administrative staff on best fiscal practices and implementation. In FY 2014 the audits will be expanded to twice each year.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-JUV-20: The Department Of Juvenile Justice Does Not Have A System In Place For Monitoring Its Facilities (Continued)**

Management's Response and Corrective Action Plan (Continued)

New policies and procedures are being developed to ensure compliance with internal audit recommendations. The Fiscal Branch Internal Auditor will maintain documentation to support the review of the facilities and copies of the audit letters communicating any findings and recommendations for improvement. The audit letter, written by the Administrative Services Director, is sent to the respective Facility Superintendent, Regional Director and Deputy Commissioner for Operations. The Facility Superintendent is required to submit a corrective action plan in response to the audit letter.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-JUV-21: The Department Of Juvenile Justice Did Not Have Adequate Internal Controls In Place At Its Facilities

We performed site visits at certain DJJ facilities, as part of our FY2012 audit. We noted the following internal control weaknesses during our visits at these facilities:

- The fiscal manager at the Center is responsible for collecting cash, making deposits, posting transactions to the general ledger and the eMARS statewide accounting and reporting system, and reconciling the bank account. These are incompatible duties that should be separated. However, there is no backup person available at the Center to assist the fiscal manager or assume those duties when she is away from the office.
- There is no independent review of the Center's bank reconciliations. Although the bank reconciliations are completed on a monthly basis, the reconciliations should be reviewed by either a supervisor or someone not involved in the routine daily operations. Independent reviews are a key component of good internal controls. While the current DJJ "Policy 315, IV-G." only calls for a quarterly review of the deposits and disbursements, we believe a monthly reconciliation and review is necessary.
- We noted that financial management responsibilities are currently being performed by youth workers and youth worker supervisors whose primary responsibility is caring for the well being of the kids. In placing this additional responsibility on the youth workers, both fiscal and programmatic responsibilities are negatively impacted, as bookkeeping and office responsibilities become secondary to caring for the kids.

Failure to adequately separate the fiscal manager's duties could lead to undetected errors and omissions, as well as incorrect financial reports and budgetary assumptions. By not having an independent review of the bank reconciliations, if errors or omissions occurred, they would remain undetected; incorrect financial data could be reported to DJJ management; and, the center could be reimbursed for incorrect or unsubstantiated amounts.

A properly designed internal control system should prevent one individual from having custody and control over two or more of the following duties: authorizations and approvals, custody of assets such as collecting cash and making the deposits, recordkeeping, and reconciliations. By not separating these responsibilities, it puts both the agency at risk and the employee at risk and it increases the risk of errors or fraud, should they occur, of remaining undetected.

Job duties should be segregated so that an employee responsible for handling checks does not authorize transactions or reconcile the bank accounts and post transactions in eMARS. The objective of segregation of duties is to ensure that assigned duties are separated such that no one employee or group of employees is in a position both to commit and conceal errors or irregularities in the normal course of performing their assigned duties. In general, the principal incompatible duties to be segregated are:

- Authorization of transactions
- Custody of assets, and
- Recording or reporting of transactions.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-JUV-21: The Department Of Juvenile Justice Did Not Have Adequate Internal Controls In Place At Its Facilities (Continued)

Adequate segregation of duties reduces the likelihood that errors, either intentional or unintentional, will remain undetected. This is carried out by providing for separate processing by different individuals at various stages of a transaction and for independent reviews of the work performed.

DJJ Policy 315 - Use of Non-Governmental Funds and Youth Activity Funds (4) g, says the following, "The primary trustee of each fund shall review the account at least quarterly and certify the accuracy of the deposits and disbursements."

Recommendation

In its oversight of the facilities, we recommend the Department of Juvenile Justice consider the following steps to strengthen fiscal management controls:

- Provide training, guidance, and management oversight to assist the facilities with their fiscal management responsibilities.
- Develop fiscal policies requiring facilities to reconcile and review all accounts on a monthly basis; the reviewer should be independent of the person performing the reconciliation.
- Evaluate the fiscal manager's office responsibilities at these facilities to ensure that duties are appropriately divided among the available staff.
- Ensure the administrative office staff is sufficient to prevent the youth workers from assuming the daily accounting responsibilities. If additional staffing isn't feasible, duties should be divided appropriately among the available office staff.

Management's Response and Corrective Action Plan

- *The Department recognizes the need for separation of fiscal duties in the group home setting. In order to address this deficiency, there will be an Administrative Specialist III position created and filled for each of the group homes. Their duties will encompass fiscal activities, time keeping, food service reporting and ACA coordination.*
- *To provide an adequate separation of duties in larger facilities, cash received for Youth Activity sales, staff meals sold and KECC donations will be accepted by someone other than the Fiscal Manager. Fiscal Managers will write receipts to that person for the cash and create the deposit. Deposits will be reviewed and signed by the Superintendent who will also review and sign the bank account reconciliation each month.*

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-JUV-21: The Department Of Juvenile Justice Did Not Have Adequate Internal Controls In Place At Its Facilities (Continued)**

Management's Response and Corrective Action Plan (Continued)

- *Superintendents will be required to review and sign ProCard purchase requests/receipts and incoming invoices to ensure management oversight at the facility level. Fiscal Managers will be required to provide Superintendents with a monthly eMars expenditure report.*
- *Fiscal policy and procedures are being developed to require fiscal management staff to reconcile all accounts on a monthly basis. In addition to the Superintendent's review the Fiscal Branch Internal Auditor will be able to review them as an independent agent thru the implementation of shared software and online banking.*

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-JUV-22: The Department Of Juvenile Justice Did Not Provide Adequate Oversight Of Facility Accounts Or Provide Guidance On Accounting For Youth Activity Funds**

We performed site visits at certain DJJ facilities as part of our FY2012 audit and noted the following control weaknesses:

- DJJ facilities are commingling governmental funds with non-governmental funds and depositing these funds into one DJJ bank account. The non-governmental funds include meal receipts, canteen money, vending machine money, KECC collections, donations, interest income, and profits earned from youth work projects. DJJ's current policy at "DJJ 315, IV-C" says that all funds are to be held in one bank account.
- DJJ has no standardized allowance and compensation rates for youth under their care. The allowance and compensation rates paid to the youth are recommended by the superintendent of the facility for approval by the education branch manager or designee. The pay rate is currently included and paid from each programs operating budget, but there is no standard policy among the facilities. Currently, there are youth development centers, group homes, day treatment centers, and detention centers, but there are no standardized rates for the allowance money paid to the youth.
- DJJ has no standardized reporting method for the facilities to use to request reimbursement - for example, names or case numbers of the kids, the number of kids in care, hours worked, and hourly rates paid. DJJ currently has no system in place for verifying the accuracy and completeness of what is submitted by the facilities before the reimbursement is made.
- Bank accounts and credit card accounts were established by a facility superintendent and fiscal manager without the prior authorization and approval from DJJ and the Finance and Administration Cabinet.

DJJ policy recommends that all funds be maintained in one account. However, DJJ does not provide adequate oversight of these accounts.

DJJ's current policy for the maintenance and use of non-governmental and youth activity funds is not specific and allows the facilities to set their own hourly rates. There are no standardized rates for the various phases of the youth work programs.

DJJ did not have a system in place for monitoring the receipts and disbursements processes at the facilities during FY2012, which would include verifying the existence of all accounts.

The weekly reimbursements to the facilities are the basis for budgetary assumptions and determining the "Other Care and Support" line item in the facilities budgets. Therefore, the preparation and comparison of budgets are difficult due to the inconsistencies in reporting among the facilities. DJJ cannot track the financial activities of the facilities because there is no required reporting mechanism for the facilities.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-JUV-22: The Department Of Juvenile Justice Did Not Provide Adequate Oversight Of Facility Accounts Or Provide Guidance On Accounting For Youth Activity Funds (Continued)

Governmental Funds should not be commingled with non-governmental funds. Facilities should not open bank accounts and credit card accounts without the prior approval of DJJ and the Finance and Administrative Cabinet. DJJ should be monitoring the financial activities of these facilities on a periodic basis, which includes verifying activity of these accounts.

DJJ Policy C. - Youth Activity Funds and youth's individual funds shall be kept in one bank account. "The facility shall maintain an acceptable accounting system necessary to ensure an accurate accounting of these funds. Individual personal earnings shall only be entered into that individual's personal account."

Each program shall set forth in their Standard Operating Procedures Manual Guidelines for Work Details, to include allowance and/or compensation schedules. Allowance and/or compensation schedules shall be recommended by the Superintendent for approval by the Education Branch Manager or designee and shall be paid from the program's annual operating budget.

KRS 45A.655 (1) states,

"...any budget unit may establish one (1) or more imprest cash funds when provided for by appropriation or when authorized by the Finance and Administration Cabinet for the purpose of making disbursements..." In section (2), it further states, "A custodian shall be designated by the head of the budget unit and, after appropriate instruction and testing, certified by the Finance and Administration Cabinet as qualified to administer the fund." Finally, section (3) states, "The agency head shall be responsible for expenditures authorized from the funds, and the custodian shall be responsible for administration of the fund."

Recommendation

We recommend DJJ implement the following controls to standardize the policies and procedures used by the facilities and monitor facility accounts:

- Revise the policy to no longer require governmental and non-governmental funds be deposited into one bank account.
- Review the policy for the Youth Work Programs and standardize the pay rates for similar work programs where possible.
- Standardize the form that is used for requesting the weekly reimbursements from the Central Office. Verify the accuracy of the reimbursement request prior to payment.
- Monitor the receipts and disbursements at the facilities and request statements for all accounts during monitoring visits. Track bank accounts in use at the facilities by requesting a list from the Finance and Administration Cabinet.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-JUV-22: The Department Of Juvenile Justice Did Not Provide Adequate Oversight Of Facility Accounts Or Provide Guidance On Accounting For Youth Activity Funds (Continued)****Management's Response and Corrective Action Plan**

- *Revise DJJ 315 to reflect current practice of establishing separate bank accounts for Youth Activity funds from other non-governmental funds including meal receipts and KECC donations. Fiscal Branch Internal Auditor will monitor receipts and disbursements at the facilities and request statements for all accounts during audits. Fiscal Branch Internal Auditor is to complete the request forms to add the bank accounts to the list held by the Finance and Administration Cabinet.*
- *Allowance and compensation rates will be standardized in DJJ Policy and Procedure based on an agreed formula with input from Program Operations management.*
- *A standard form will be created for submission to Fiscal Branch for reimbursement and will include the last name of the youth and hours worked if applicable. This information will be verified by population reports and payment will be created and disbursed by the Fiscal Branch.*
- *All fiscal management staff, Superintendents, and Directors have received notification and training regarding current Finance policy that defines the state procurement card as the only credit card allowed and no other purchasing cards shall be used.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-JUV-23: The Department Of Juvenile Justice Did Not Have Adequate Controls In Place Over The Timekeeping Process At The Facilities

We tested the internal controls over DJJ's payroll process. Based on the information provided, we noted the following internal control weaknesses over the timekeeping process:

- Timekeepers at DJJ entered their own time into the Kentucky Human Resource Information System (KHRIS) and also had responsibility for reconciling the payroll records, during FY12. This combination of duties is incompatible. Under this system of controls, if errors or omissions occurred, they would remain undetected. These responsibilities concentrated in one employee provide an opportunity for the payroll information to be manipulated. The failure to put preventive controls in place leaves the employee and the agency at risk.
- One timesheet was not signed by the employee or the supervisor; one timesheet was signed by the supervisor, but not the employee; and, one timesheet where the employee's leave was not approved. When an employee does not sign their timesheet they are not certifying that the reported time is accurate and complete. When a timesheet is not signed by the supervisor there is no evidence to show the time reflected on the timesheet was reviewed and approved and is accurate and complete prior to posting in KHRIS. Similarly, if leave time is not authorized and approved, it increases the risk of inaccurate reporting or falsification of leave time.

DJJ does not have an independent reviewer entering time for the timekeepers or reviewing the reconciliation of time that is entered in KHRIS. The agency should have a system in place to track employee leave time to support what is reported on timesheets and entered in KHRIS.

Good internal controls dictate that timekeepers should not enter their own timesheet data, which includes leave time and overtime, into KHRIS and reconcile payroll records.

In addition, good internal controls dictate that payroll and leave records are accurate and complete, properly authorized, and approved.

Recommendation

We recommend the Department of Juvenile Justice consider the following controls over the payroll and timekeeping function:

- Develop and implement a policy that requires an independent person to enter the timekeeper's time and reviews the reconciliation of time entered in KHRIS.
- Require all timesheets and leave requests to be signed by the employee and authorized and approved by the supervisor.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-JUV-23: The Department Of Juvenile Justice Did Not Have Adequate Controls In Place Over The Timekeeping Process At The Facilities (Continued)

Management's Response and Corrective Action Plan

- *Corrective action has been taken to ensure that Timekeepers no longer enter and review their own timesheets in KHRIS.*
- *New policies and procedures are being developed to require employees and supervisors to sign all timesheets and leave requests authorized and approved by the supervisor.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-JUV-24: The Department Of Juvenile Justice Did Not Have A Formal System In Place For Processing The Receipts And Disbursements Of The Facilities

As part of our testing of controls over facility expenditures reimbursements, we determined that DJJ does not have a formal system in place for processing the receipts and disbursements of the facilities. DJJ lacks sufficient controls for tracking the financial activities of the facilities.

We tested a sample of DJJ expenditures to determine the effectiveness of controls in place over facility reimbursements. Based on the information provided for the sample items tested, we noted four expenditure transactions that were not properly authorized and approved by appropriate personnel. For the same transactions, we noted the supporting documentation that was submitted by the facilities was inadequate and it could not be determined what was purchased.

There is no formal approval process in place when supporting documentation for expenditures are received from facilities. In some cases the approvals are made before the supporting documentation is received. While our testing noted four exceptions of transactions with insufficient support, we were able to determine from the information provided for the remaining sample items that sufficient justification existed for the approval of those expenditures.

Without appropriate supporting documentation, DJJ has no way to verify the propriety of facility expenditure reimbursements. By not having controls in place, DJJ has no way of ensuring that funds are being used for their intended purpose.

Good internal controls dictate that invoices for purchases are signed, authorized and approved by appropriate personnel prior to payment. Further, expenditure documentation should be sufficiently detailed to enable an independent reviewer to determine the nature of the item(s) purchased and if the purchase had a business related purpose.

Recommendation

We recommend the Department of Juvenile Justice implement the following controls over facility disbursements:

- Expenditures should be properly authorized and approved by the fiscal manager and superintendent at the facility before they are sent to central office in Frankfort.
- Expenditure documentation should be sufficiently detailed to show that purchases are reasonable and necessary.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-JUV-24: The Department Of Juvenile Justice Did Not Have A Formal System In Place For Processing The Receipts And Disbursements Of The Facilities (Continued)**

Management's Response and Corrective Action Plan

- *Beginning with FY 2013, procurement requests follow an email process defined by the level of approval required based on the dollar amount of the requested purchase. Purchase requests under the small purchase authority of \$1,000, including appropriate justification, are emailed through the supervisory chain to the Director for approval. All requests over the small purchase authority are forwarded to the Fiscal Branch Manager by the Director and approved based on the availability of funds. Purchases in excess of the \$1,000 limit are processed by the Procurement Officer in the Fiscal Branch.*
- *Signed quotes, invoices, receipts, email approvals and other supporting documentation will be attached to the original payment document before submitting to the Fiscal Branch and Finance Administration for approval. Original documentation will be retained by the Branch.*

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-25: KDE Did Not Follow The Policy Currently In Place With Regard To The Review And Approval Process For School District SEEK Payments**

During our testing of the Kentucky Department of Education's (KDE) Support Education Excellence in Kentucky (SEEK) funding program, we identified 14 transactions that lacked evidence of the appropriate authorization for payment. For six of the transactions, the Division Director did not provide their initials to signify approval of the related payment memo. Likewise, the initials of an authorized reviewer were missing on the payment memos for eight transactions.

The failure to properly document the review and approval process of SEEK payment memos is likely due to oversight error.

The omission of an authorization step in the processing of a payment memo is contrary to KDE's documented SEEK payment policies and procedures. Those policies and procedures require evidence that the personnel responsible for authorizing such payments has reviewed, approved, and/or taken responsibility for the transaction. Failure to properly review and document evidence supporting the approval is an internal control deficiency.

KDE's policies and procedures require that the approval of each SEEK payment memo be substantiated with the initials of the District Funding & Reporting Branch Manager next to the preparer's signature, and the initials of the Director of the Division of District Support next to the Division Director's name.

Recommendation

We recommend KDE follow the policy currently in place with regards to the review and approval process for SEEK payments. All signatures and initials required on the supporting documentation should be present after each step of the review and approval process.

Management's Response and Corrective Action Plan

In response to the November 13, 2012 "Record of Control Weakness" regarding authorizations for SEEK payments, KDE has updated the written procedure for processing SEEK payments. Back up personnel have been identified to review payment documents in the event a primary authorizer is absent. This written procedure will allow staff to ensure each payment document is correctly reviewed and approved prior to the payment being processed.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-26: KDE Was Not Compliant With KRS 157.410 In The Calculation Of First Quarter Fiscal Year 2012 School District SEEK Payments**

During our audit of the Kentucky Department of Education's (KDE) Support Education Excellence in Kentucky (SEEK) funding program, we noted that the basis utilized in calculating school district SEEK payments for the first quarter of fiscal year (FY) 2012 was noncompliant with the calculation method required by Kentucky Revised Statute (KRS) 157.410. Consequently, five of the school districts tested were incorrectly advanced a total of \$819,192 during the first quarter of FY 2012. Because all school district SEEK payments were based upon the incorrect basis, we could not determine if the other 169 school districts would have been incorrectly advanced during the first quarter of FY 2012.

We did note, however, that the SEEK payment formula utilized in the second quarter and the final six-months of FY 2012 was accurate. Accordingly, the school districts received the correct total of SEEK funds by the end of FY 2012; therefore, no financial adjustment is necessary.

The first quarter of FY 2012 SEEK payments to school districts appear to have been calculated based on the forecasted SEEK total for the fiscal year. The calculation of the SEEK payments for the first quarter should, however, be based upon the prior year's allotment, reduced by any capital outlays and/or the SEEK nickel state equalization.

Use of the incorrect basis for calculating the first quarter FY 2012 SEEK payments resulted in at least five of the school districts receiving an additional \$273,064 per month in July, August, and September 2011. The unauthorized use of additional funds in the first quarter limited the availability of state resources for other state needs or uses during that time.

KRS 157.410 states that "On July 1, August 1, and September 1, of each fiscal year, one-twelfth of the prior year's allotment minus the capital outlay shall be paid each school district." Instead of basing the first quarter's monthly payments on the prior year SEEK allotment KDE used the fiscal year twelve forecasted SEEK amounts to calculate the payments.

Recommendation

We recommend KDE implement an internal control to assure compliance with KRS 157.410, requiring the use of prior year SEEK allotment for the basis of July, August, and September SEEK payments. The SEEK formula utilized should be reviewed, approved, and signed-off by appropriate personnel prior to disbursement of funds.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-26: KDE Was Not Compliant With KRS 157.410 In The Calculation Of First Quarter Fiscal Year 2012 School District SEEK Payments (Continued)**

Management's Response and Corrective Action Plan

In response to the November 13, 2012 "Record of Control Weakness/Record of Noncompliance" regarding the SEEK forecast calculation, KDE submits the following:

For many years, the SEEK Forecast calculation has been used to determine the payment amounts for the first several months of a fiscal year. It appears the practice was changed from utilizing the prior year's allotment in order to create more accurate payment amounts. For example, a district anticipating growth of AADA, would be able to capture that growth and the SEEK payments for the following year using the SEEK Forecast would more accurately reflect the actual attendance levels, rather than waiting several months to capture the updated data in the SEEK tentative calculation. The converse would also apply. The practice of utilizing the most recent data projections minimizes the fluctuation in monthly payments between the forecast and tentative calculations and allows for a more predictable revenue stream for the districts. The difference between the two methodologies is the timing of the revenues. Each district receives the total amount of SEEK funding to which they are entitled for the year, it is merely a matter of when that revenue is received. Utilizing the SEEK forecast calculation more closely matches the revenue with actual data.

The APA 'Record of Controlled Weakness/Record of Noncompliance' states:

'Consequently, five of the school districts tested were incorrectly advanced a total of \$819,192 during the first quarter of FY 2012'.

KDE does not take issue with the wording of 'incorrectly advanced'; however, KDE's approach results in a practical payment methodology to allow school districts to operate in an efficient and effective manner throughout the year. In the subsequent three quarters of FY 2012, those five districts' payments will be adjusted either upward or downward, depending on the results after all actual data is received and utilized in the SEEK calculations, and this will result in the total annual SEEK amount distributed by the end of the year to be accurate as a whole.

The APA 'Record of Controlled Weakness/Record of Noncompliance' states:

'The unauthorized use of additional funds in the first quarter limited the availability of state resources for other state needs or uses during that time.'

This statement is inaccurate due to the SEEK allotment being used for SEEK purposes only.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-26: KDE Was Not Compliant With KRS 157.410 In The Calculation Of First Quarter Fiscal Year 2012 School District SEEK Payments (Continued)**

Auditor's Reply

While we recognize that the methodology used for calculating this SEEK payment may be more economical and efficient, nevertheless Kentucky Revised Statute (KRS) 157.410 states that "On July 1, August 1, and September 1, of each fiscal year, one-twelfth of the prior year's allotment minus the capital outlay shall be paid each school district." The statute specifies the methodology to be utilized in calculating each school district's SEEK payment. Regardless of the practicality afforded through use of the current SEEK payment determination, failure to follow the required KRS constitutes an infringement of state law.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KDE-27: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Did Not Consistently Apply Logical Security Policies For The KETS Network And MUNIS

Our fiscal year (FY) 2012 audit of the Kentucky Department of Education (KDE) system controls revealed weaknesses related to the Office of Knowledge, Information And Data Services (KIDS) security surrounding the Kentucky Education Technology System (KETS) network and the Municipal Information System (MUNIS). However, some improvements were made since the prior year audit. Although KDE developed an overarching Security Program, Acceptable Use Policy, and Access Control Policy to address appropriate use of resources within KDE, these policies did not specifically address IT responsibilities associated with the KETS network and MUNIS. Further, none of these addressed security controls specific to the KIDS servers. The agency indicated discussions were in process for a policy governing the IT responsibilities for MUNIS and the KETS network; however, this policy was not implemented. Similar issues have been addressed to the agency during the past five audits.

KIDS management is responsible for central workstations and servers, as well as KIDS-related employee and contractor network access. Audit logging was enabled by KIDS for all UNIX and Windows-based servers; however, no security policy was formalized at the central level concerning procedures to periodically review the audit logs for users with high-level privileges.

All KDE users were granted Local Administrator rights on their workstations. Local Administrator rights provide users the ability to install applications on individual machines connected to the agency network. This is considered unnecessary access for most KDE employees. Technical and support staff should be the only personnel with this level of access to prevent the accidental or intentional introduction of viruses or the loss of programs or data and to ensure workstations utilize only approved software.

In addition, an access request form was not developed for requesting and granting access to the KDE Gateway server. Currently, the KIDS Data Center Services team grants server access. The level of access is determined by the Division of District Support (DDS). Requests are processed through the KETS Service Desk and employees are required to sign Confidentiality Agreements upon hire. Although documentation was retained for new users, it did not require the level or type of access to be stipulated. Discussions with the agency revealed the Gateway server will likely be decommissioned after all of the Kentucky school districts' MUNIS servers are migrated to a cloud computing environment.

Four users were added to the established security groups on the Gateway server since our FY 2011 review. Of the four users added, three, or 75 percent, lacked supporting documentation substantiating the new group membership. Therefore, there was no way to validate the necessity of access. We also identified ten disabled accounts on the Gateway server that remained members of one or more security groups on the server. KIDS staff indicated during audit fieldwork the disabled accounts were deleted from the password and group directories.

Although KIDS had not implemented a formal security policy related to specifically accessing MUNIS servers or software in the districts, an informal process was in place for KDE or KIDS staff to first obtain authorization from the school district before accessing the district's MUNIS server or software.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KDE-27: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Did Not Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)

A log was maintained at KIDS to track access to district servers by the root account. However, a review of this log revealed the activity being captured does not include the district server being accessed. We are aware KDE is migrating the Kentucky school districts' MUNIS servers to a cloud computing environment. Once finalized, the MUNIS vendor will host all application data as opposed to each school district maintaining an on-site server, and the school districts will connect securely to the vendor's servers. At that point, there will no longer be a need for KDE or KIDS staff to access the district servers.

Without strong, formalized logical security controls, the opportunity increases for unauthorized modification to financial and staffing reports as well as the likelihood of errors or losses occurring from incorrect use of data and other resources. Granting users local administrator rights to their workstations allows those users the ability to download and install unauthorized software as well as possibly pirated data.

Formalized security policies set the tone of management concern for strong system security and provide a security framework used to educate management and users of their responsibilities. System security should be administered in such a way as to ensure proper segregation of duties. System access should be limited to the level necessary for performing assigned duties, and system accounts should not be shared to ensure individual user activity could be tracked. Granting users system administration access to their computers increases the likelihood that unauthorized and unlicensed software could be installed and increases the chance of system attacks by viruses or other malware.

Further, access to servers that house critical financial and staffing data should be restricted to only necessary employees. Intruders often use inactive accounts to break into a network. If an account is not used within a reasonable period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will access the account. Accounts that are not anticipated as being used in the future should be periodically purged. Finally, system user accounts and audit trails should be reviewed periodically in order to ensure identification and tracking of user activity.

Recommendation

We recommend KIDS standardize security responsibilities for all KIDS employees and ensure critical programs and data related to the KETS network and MUNIS, as well as the servers housing such data, are properly secured. The agency should, at a minimum:

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-27: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Did Not Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)**

Recommendation (Continued)

- Develop formal procedures related to the management of locked and disabled accounts pertaining specifically to the KETS network and MUNIS. These procedures should address the process of disabling or removing terminated employee accounts, as well as unnecessary generic accounts. Accordingly, a methodology should be developed so that a distinction can be made between accounts that can be safely removed versus accounts that must be retained on the server for performance reasons or audit trail history. These procedures should include the requirement for a periodic review of disabled and locked accounts to determine their necessity. If an account is deemed unnecessary, it should be permanently removed from the KIDS servers unless there is a pragmatic reason for maintaining the account, in which case it should be, at a minimum, disabled. All disabled accounts should be removed from current group membership on the KIDS servers.
- Evaluate all security group assignments on the KIDS servers to ensure that all assigned users require membership in the assigned groups.
- Implement procedures to periodically review security audit logs with special attention being given to users with high-level privileges so that inappropriate use of resources can be further investigated, if the need arises. These reviews can be performed on a periodic basis for a sample of accounts or days to make them more manageable. Documentation of these reviews should be retained for audit purposes.
- Restrict Local Administrator rights to technical and support staff.
- Develop and implement a user access request form to explicitly identify access being requested to resources or data and all necessary approvals required. All users, both internal and external to KDE, requesting access to KDE resources or applications should be required to complete this form. The completed forms should be approved by appropriate management and should be maintained in the users' files as supporting documentation for their access. Until an access request form is established, KIDS should continue to use KETS Service Desk tickets to establish or alter access. These tickets should stipulate the specific level of access being requested and should be maintained for audit purposes.
- Ensure sufficient information is captured with the log used to track access to the district servers to allow the reviewer to determine the server on which the activity took place.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-27: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Did Not Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)**

Management's Response and Corrective Action Plan

There is a current KDE project to migrate the MUNIS application to another operating system and hardware platform. This project is currently on schedule. Once complete, KDE staff will no longer be responsible for managing user accounts with access to MUNIS systems. KDE will continue its current process to ensure that MUNIS user accounts belonging to terminated employees are deleted or disabled, except where the disabling of such accounts will interrupt normal operation. KDE will continue its current process of reviewing and removing Active Directory accounts, upon which the MUNIS system is dependent for access.

A policy requiring review of server security group assignments is under development.

KDE does not have adequate resources, staff or tools to regularly review security logs in an effective and efficient manner. Logs are retained short-term for review once an incident/issue is identified.

KDE continues to investigate methods available to reduce the number of KDE staff with Local Administrator rights to their workstations.

KDE will continue to expand, enhance and standardize the electronic access control processes for permissions to network and critical applications.

There is a current KDE project to migrate the MUNIS application to another operating system and hardware platform. Once complete, KDE staff will no longer be responsible for maintaining the district MUNIS servers. We will continue to investigate new methods to capture the MUNIS district server identification within the district server access log.

Auditor's Reply

Although we acknowledge KDE does not have adequate resources, staff or tools to regularly review security logs, our recommendation is to either identify an automated tool to assist in performing periodic reviews or limit the reviews to a sample of accounts or days to make this process more manageable. We specifically recommend that focus be placed on users with high-level privileges, which should further limit the amount of data to be reviewed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KDE-28: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Did Not Consistently Apply Program Modification Procedures

Our fiscal year (FY) 2012 audit of the Kentucky Department of Education (KDE) system controls revealed the program modification process developed by the Office of Knowledge, Information and Data Services (KIDS) is not sufficient to ensure only authorized changes to the Information Technology (IT) environment, which includes the Municipal Information System (MUNIS), are made. Further, the procedures in place were not consistently followed for changes completed within the audit period. Similar issues were noted for the past six audits; however, some improvements have been made during the current fiscal year.

KIDS developed and implemented a formalized Change Management Policy and Procedures Manual. This manual stipulates changes made to the IT environment must be documented on a properly completed and approved Request for Change (RFC) form. However, the manual does not specify the individuals responsible for performing testing of a proposed change or migration of a change to production. The current informal process has members of the MUNIS Support Team and one MUNIS vendor employee responsible for testing MUNIS-related changes. On the approval of the Project Manager, MUNIS-related changes are moved into production by a member of the MUNIS Support Team. This informal process could lead to an issue regarding segregation of duties between the request for change, development of the change, testing of the change, and promotion to production. It could also lead to a failure to complete any one of these tasks.

Additionally, our review of two KDE utilities revealed 196 lines of code changed within one utility program affecting processing. An associated RFC form was provided; however, it did not reflect the date in which testing was performed. Further, the description of the change did not adequately detail the changes made, and the form indicated the RFC was initiated in October 2010 and was completed in November 2010. The utility code changes under review, however, were all completed in 2011.

Further, nine MUNIS-related changes were identified since the prior year audit. We noted eight of the nine associated RFC forms, or approximately 88.9 percent, were incomplete. Specifically,

- Three forms marked as emergency changes lacked the required division manager approval.
- One form, although containing division manager approval, lacked first and second line approvals.
- Six forms did not have all fields completed within the testing section.
- Two forms did not list the completion date.
- Three forms did not include the person responsible for implementing the change.

Finally, an examination of the Forward Schedule of Changes (FSC) log maintained for all KDE changes revealed 82 changes completed subsequent to our prior year review. Of those changes, we noted 54 changes, or 65.9 percent, failed to document the actual start and completion times.

Failure to properly apply and monitor change control procedures increases the risk that incorrect or unauthorized changes could be made to critical applications and, potentially, be moved into the live production environment.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-28: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Did Not Consistently Apply Program Modification Procedures (Continued)**

Program modification control procedures should be consistently applied in order to ensure that only appropriately authorized changes to critical applications are made and implemented within the production environment. All program modifications are to be requested on a Request for Change form. They should be monitored and thoroughly documented, with procedures established to log all program change requests, review and approval processes to be followed, and supporting documentation to be maintained for the process. Changes to KIDS utilities should also be included in the change management process.

Recommendation

We recommend an expansion of the KIDS Change Management Policy and Procedure manual to identify specific individuals or groups responsible for performing changes, testing changes, authorizing promotion of changes, and moving changes into production. All change management controls should be consistently applied to critical system software and utility programs.

The requirement for support related to changes to the utility programs should be expanded. In the event a major change is made to a utility program, KIDS should perform a comparison of the old and new versions of the utility code to determine which lines specifically were changed and provide an explanation of the necessary changes. In instances where a minor change to a utility program is required, KIDS should provide a summary of the changes made. This can be done for each module or section of code changed and should be attached to the associated RFC form.

RFC forms as well as other supporting code compare or change descriptions should be maintained for audit purposes. KIDS should ensure the RFC form is completed in its entirety to include all necessary approvals, testing names and dates, completion dates, and implementation contact information. Further, all fields should be completed in the FSC log so that it can be accurately tied to the RFC form.

Management's Response and Corrective Action Plan

There is a current KDE project to migrate the MUNIS application to another operating system and hardware platform. The project is currently on schedule, including the migration of all district MUNIS machines to the cloud. Once complete, onsite vendor staff will no longer be responsible for maintaining utility codes.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KDE-28: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Did Not Consistently Apply Program Modification Procedures (Continued)**

Management's Response and Corrective Action Plan (Continued)

KDE is currently in the process of replacing the KDE/KIDS Change Management documentation and tracking system. The following improvements will be added to the documentation as part of this process:

- *Identify groups responsible for performing, testing, and approving changes for critical system software and utility programs.*
- *KDE will more explicitly document the RFC approvals and those individuals responsible for the approvals, as well as, look for ways to improve or automate the process within the new tracking system.*
- *KDE will review the closure process to ensure dates are completed.*

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KEHP-29: Beginning Trust Fund Balance of the Kentucky Public Employees Health Insurance Program Had To Be Restated Due To A Significant Overstatement Of Accounts Receivable In Fiscal Year 2011**

When preparing the Kentucky Employee Health Plan (KEHP) fiscal year (FY) 2012 financial statements, a significant error in reporting the FY 2011 premiums receivable was identified. This error was related to a misstatement of premiums receivable in FY 11 resulting in a \$12,058,776 adjustment to the assets balance and fund net asset balance in the current year.

The Personnel Cabinet implemented the Kentucky Human Resource Information System (KHRIS) during spring 2011. This system accounts for all personnel costs, including KEHP billing and receipts. When the system is unable to match a premium payment to the payor, KHRIS places the amount into clarification status for staff to research and credit to the proper account. Despite this delay in assigning the payment, deposit of the funds occurs promptly and receipt is recorded in the Enhanced Management and Reporting System (eMARS), the state's accounting system.

Department of Employee Insurance (DEI) employees responsible for gathering information used to prepare the FY 2011 financial statements were still unfamiliar with KHRIS processes, so they did not compare amounts in clarification status to accounts receivable. Also, KHRIS reconciliation processes had not yet been established to note discrepancies between amounts posted to accounts and amounts received. DEI has since implemented periodic reconciliations.

An automated premium payment of \$12,058,776 made in late June 2011 did not post to the payor's account, so that amount was included in accounts receivable. Because the payment was already a portion of cash on hand, this led to an overstatement of June 30, 2011 premiums receivable, total assets, and fund net assets in the financial statements issued at the conclusion of FY 2011.

Generally accepted accounting principles (GAAP) have been established to allow readers of financial statements the ability to assess an organization's performance from the reliability, comparability, and consistency of financial information presented. Further, the goal of GAAP is to ensure that efforts be made to report financial information accurately, which includes properly reporting receivables only when due and cash has not been received as of the year end.

Recommendation

We recommend DEI correct the \$12,058,776 error. It is our understanding that DEI will be correcting the premium receivable and disclosing the prior period adjustment in the notes, as required by accounting standards.

We further recommend DEI ensure that its reconciliation process and review of items in clarification status are performed effectively and in a timely manner to prevent a similar misstatement in the future.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KEHP-29: Beginning Trust Fund Balance of the Kentucky Public Employees Health Insurance Program Had To Be Restated Due To A Significant Overstatement Of Accounts Receivable In Fiscal Year 2011 (Continued)**

Management's Response and Corrective Action Plan

The Department of Employee Insurance (DEI) appreciates the efforts of the State Auditor of Public Accounts (APA) to ensure financial statement information is reported accurately. Management has corrected the June 30, 2011 financial statements for the Trust Fund to reflect an adjustment to premium revenues and premium receivables. Disclosure has been added to the footnotes (see Note 21), disclosing the impact on the June 30, 2011 financial statements.

DEI staff and management discovered the error during the mid-year compilation. The mid-year compilation is an additional control added by management, starting at December 31, 2009, to review and detect potential financial statement reporting issues on an interim basis. When DEI discovered the error, management notified the Auditor of Public Accounts' staff of the prior period misstatement.

An additional control is the premium reconciliation that DEI continues to improve upon and perform on a more timely basis as the reconciliation process is refined and becomes more efficient. At June 30, 2011, the KHRIS System had only been operational for 3 months and the DEI team was working through a new feature entitled the "Clarification Process" that affected both premium revenues and premium receivables upon reconciliation. Items in clarification status have been added to the general premium reconciliation template to ensure they are considered during the reconciliation process. The improved development of the premium reconciliation process, now being performed on a monthly basis, will alert management to any errors on a timely basis. We appreciate your continued efforts to assist in securing the financial resources of the Personnel Cabinet and to improve the Cabinet's financial controls and management.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KEHP-30: The Lack Of Static Payroll Reports In KHRIS Caused DEI Premium Reconciliations To Be Delayed And Incomplete During Fiscal Year 2012

As we noted in our previous audit, in fiscal year 2012 (FY 12) the Kentucky Human Resource Information System (KHRIS) lacked a feature to allow the production of static reports needed to perform month-end closing procedures. As a result, our FY 12 audit of the Kentucky Employee Health Plan (KEHP) noted incomplete reconciliations of premium receipts recorded in KHRIS to receipts recorded in the Enhanced Management and Reporting System (eMARS, the state's accounting system). These reconciliations are a key control to ensure all premiums due are received and recorded accurately.

When KHRIS was implemented in April 2011, it lacked numerous features necessary to ensure effective oversight of premium receipts. In particular there was no month-end closing, and amounts in the limited reports available changed with corrections made later; no reports were static. These system weaknesses made reconciling KHRIS to eMARS very difficult. Significant unreconciled discrepancies led to fiscal year 2011 (FY11) audit findings on the lack of static reports and an ineffective reconciliation process.

The Personnel Cabinet's Department of Employee Insurance (DEI) acted on recommendations contained in those findings. They worked with the KHRIS vendor and members of Personnel's KHRIS team to design reconciliation processes and develop specifications for a static report (the BVDA report) that would permit effective reconciliations. Pending completion of this process, DEI implemented the compensating control of running reports immediately upon completion of every payroll run, and DEI employees began the task of reconciling premium accounts. Beginning with January 2012 this was done every month. The system weaknesses present at KHRIS implementation meant that the reconciliation of 2011 premiums began with data from all the months from April through December lumped together. Separating FY11 data from FY12 required a substantial investment in time and effort. The planned BVDA report that will streamline the process was not completed until August 2012. Therefore, performing reconciliations for the first six months of 2012 was a time-consuming and largely manual process.

The time required to complete reconciliations under these conditions is immense. As a result, at the time of FY12 financial statement preparation the reconciliation process was still underway for health premiums, health reimbursement account (HRA) payments, and flexible spending account (FSA) payments. There were 42 reconciliations of these three types covering seven time periods for both Commonwealth-paid and non-Commonwealth-paid payroll/benefit runs, but only one was fully reconciled to a difference of zero. The net impact of unreconciled differences on the trust fund was that premiums recorded in KHRIS exceeded those in eMARS by \$186,687; the net impact on the fiduciary fund was that premiums recorded in eMARS exceeded those recorded in KHRIS by \$33,302; an additional \$29 in discrepancies had not yet been assigned to a fund.

Good internal controls dictate that amounts recorded in different systems should be reconciled in order to ensure data in both systems are accurate. Reconciliations should be completed timely to achieve operational effectiveness. Further, the information system should supply adequate reports to allow for effective month-end and year-end closing activities.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KEHP-30: The Lack Of Static Payroll Reports In KHRIS Caused DEI Premium Reconciliations To Be Delayed And Incomplete During Fiscal Year 2012 (Continued)**

Recommendation

We recommend the Personnel Cabinet's Department of Employee Insurance proceed with its plans to implement the planned reconciliation process using a static report. We further recommend that DEI continue to complete its reconciliations now underway for earlier periods to ensure receipt of all premiums due to KEHP.

Management's Response and Corrective Action Plan

DEI Management agrees premium reconciliations are a key control to ensure all premiums due are received and recorded accurately. As noted above, substantial effort has been invested over the past year to develop and implement improved reconciliation procedures. Given the lack of static reports upon the initial implementation of KHRIS in April 2011 and the level of effort invested to date to get these differences down to unreconciled differences representing 0.01% of premiums in the Trust Fund and 0.21% of premiums in the fiduciary fund, it may not be cost effective to continue efforts to reduce the unreconciled differences as of June 30, 2012.

Based upon work to date, we believe the majority of remaining variances are timing issues, correcting in the following month. The monthly variances noted will be maintained in the cash position spreadsheet and we will monitor and track the trend monthly.

Management will continue efforts to improve upon and perform on a more timely basis the reconciliation process. Within the KHRIS team processes, staff will continue to develop additional reporting and improved processes, attempting to refine and become more efficient. We appreciate your continued efforts to assist in securing the financial resources of the Commonwealth and improve the Cabinet's financial controls.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KEHP-31: The Personnel Cabinet Did Not Maintain Current System Documentation To Support Processing Performed By The Kentucky Human Resource Information System

Our Fiscal Year (FY) 2012 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resource Information System (KHRIS) revealed that even though Personnel has developed basic documentation that describes critical processing performed by the system, the majority of this documentation has not been kept up-to-date or maintained over the life of the project. Further, supporting documentation related to system edits is not complete and does not connect the legacy system edits to the current program logic.

Technical and functional specification documents describing critical system components and functionality have been documented by the KHRIS Team and are maintained within the KHRIS Solution Manager application. A total of 170 documents related to health and life insurance processing and reports were identified and reviewed. This review revealed 148 documents, or 87.1 percent, were outdated, still in draft form, or did not record a document revision date. For those documents without a revision date, the auditor could not determine whether they were current. Two of these documents are associated with the Medicare Data Match process, which is required by the Federal government.

Furthermore, on March 14, 2012, approximately one year after the KHRIS system went into production, the KHRIS Team documented a comparison of edits originally established within the legacy Group Health Insurance (GHI) and Group Life Insurance (GLI) systems to those established within KHRIS. Our review of this information as it relates to health insurance revealed the following:

- Of the 293 legacy GHI edits, 108 were implemented within KHRIS; however, adequate documentation was not provided for 105 of these edits, or 97.2 percent, to show where the program logic resides within the KHRIS Solution Manager, which, as previously noted above, is the repository of KHRIS technical and functional documentation.
- Of the 293 legacy GHI edits, 28 were not implemented within KHRIS because the edit was not required since a manual review process was implemented, or a report or query was available within KHRIS that is used as a work around. Four of the edits within the legacy application were designed to review changes made to KHRIS master data in a previous pay period (retro changes) and were determined to be needed within KHRIS; therefore, a retroactive date limit, or cap, is currently planned to ensure changes made to benefits are not made six months in the past. Further, another edit related to personnel transfers was not implemented since a manual review process was developed. However, there is not an audit or review process in place to ensure all transfers and re-hires are identified and recorded within KHRIS.
- Of the 293 legacy GHI edits, 45 were not configured within KHRIS since a report was developed for staff to review or to allow DEI staff to perform a manual review of the data after processing was complete. The manual approach to review information requires a significant amount of research and additional work to be performed by the Department of Employee Insurance (DEI) staff subsequent to processing to ensure all transactions are identified and accurately recorded in KHRIS.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KEHP-31: The Personnel Cabinet Did Not Maintain Current System Documentation To Support Processing Performed By The Kentucky Human Resource Information System (Continued)**

Failure to appropriately document critical system edits and update technical documentation increases the risk that users will be unaware of changes that could potentially alter their business processes and could lead to tasks not being performed or a misunderstanding of assigned responsibilities. If system edits are not properly designed or are circumvented, there is an increased risk that data validity as well as the overall reporting processes could be materially affected.

Proper documentation should be maintained for each critical program or process in production in order to, at a minimum, identify the purpose of the program or process, the origin of data, the specific calculations or other procedures performed, and the output of data or reports. This documentation should accurately reflect edits that are processing within the system.

Recommendation

We recommend the Personnel Cabinet perform a review of all technical and functional documentation available within the KHRIS Solution Manager application, making necessary updates to accurately reflect current processing and program logic. The individual responsible for updating the documentation should properly identify each change and provide a date in which the update was made. These documents should be updated on a regular basis going forward, or as necessary based on changes made to KHRIS processing.

In addition, we recommend the Personnel Cabinet continue to work toward implementing a six month retroactive date limit on changes made to benefits data within KHRIS. Further, once the retroactive date limit is implemented, a review should be performed to ensure prior changes made to benefits and associated deductions in a previous pay period were appropriate.

In addition, we recommend the Personnel Cabinet develop and implement a formal audit process to ensure all employees that are rehired or transfer from another state agency are identified within KHRIS to ensure coverage change restrictions are enforced.

We further recommend the Personnel Cabinet consider including within the Future Design Consideration (FDC) process the 45 legacy GHI edits not currently configured within KHRIS due to the existence of a report or query being identified as a backend work around. If this is not feasible, we recommend that sufficient resources be applied within DEI to assist with the review of data to verify accuracy and completeness of processing within the system as it relates to health insurance.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KEHP-31: The Personnel Cabinet Did Not Maintain Current System Documentation To Support Processing Performed By The Kentucky Human Resource Information System (Continued)**

Management's Response and Corrective Action Plan

The Division of Technology Services (DTS) agrees that current documentation is an important control for all systems and, as recommended, has completed an initial review of the 148 documents mentioned in this comment that were stated by the APA as out of date. After reviewing, DTS has updated those documents found to be out of date and noted several of those as either current, no longer applicable or no longer needed. DTS will continue reviewing relevant documentation to ensure KHRIS documentation is current.

The Personnel Cabinet implemented a retroactive date cap in KHRIS on August 7, 2012 for the Commonwealth paid population in KHRIS and on August 8, 2012 for the benefits only population as requested on KHRIS Change Request 30009. The retroactive date cap is currently set at 01/16/2012. DTS and the business areas will continue reviewing impacts associated to this change and processes to ensure prior changes made to benefits and associated deductions in a previous pay period are appropriate.

The Transfer Report is available in KHRIS for tracking purposes of rehires and transfers. This report is monitored by the Department of Employee Insurance and the Life Insurance Branch. Updates are made to benefits accordingly. Future needs by DEI to supplement this report with additional tools will be reviewed by DTS through the DTS/KHRIS Change Request process for potential future implementation as prioritized by the business area.

DTS appreciates the review of the APA of the former systems' edits to ensure business needs are met and that appropriate system controls are in place within KHRIS. Various edits and audits are inherent to and/or built into KHRIS, but not all legacy system edits are applicable. As KHRIS is unique in design and vastly different from the former systems, not all edits are similar or would be if/when designed in KHRIS. KHRIS, still a new system, continues to evolve per business needs and recommendations such as these from the APA. As a part of the evolution of KHRIS, as time and resources allow, DTS will continue working with DEI to prioritize Future Design Considerations and KHRIS/System Change Requests for enhancements to displace reports and queries currently identified as work a rounds.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KEHP-32: The Kentucky Human Resource Information System Does Not Allow Segregation Of Department Of Employee Insurance And Life Insurance Branch Activity

Our Fiscal Year (FY) 2012 audit of the Personnel Cabinet's Kentucky Human Resource Information System (KHRIS) revealed superusers in the Department of Employee Insurance (DEI) and Life Insurance Branch (LIB) can access all the data pertaining to both groups' business processes. Current KHRIS configuration will not allow a separation of business processes between the two groups without an extensive change in the design of the system.

As a result of the current system configuration, DEI and LIB employees are able to view data from outside of their department and their scope of responsibilities.

Access to data outside of a user's scope of responsibilities should not be allowed. The reason for this control is to ensure an employee does not have an opportunity to intentionally or unintentionally view or modify data to which the employee does not require access to perform their assigned job duties. Organizations that cannot easily segregate duties should implement compensatory controls to supervise and monitor activities to ensure no unnecessary or improper transactions or modifications are taking place.

Failure to develop controls to properly segregate duties could increase the risk of inappropriate use of system data and resources, unauthorized modification to data, and errors or losses due to incorrect or unauthorized use of data and other resources.

Recommendation

We recommend the KHRIS team develop reports to allow DEI and LIB management to monitor transactions on a regular basis for their respective business areas. This review should ensure staff members are using the system as intended, based on job function.

Alternately, due to the functional limitations of KHRIS and because DEI and LIB staff perform similar processing within KHRIS as it relates to benefits, if the Personnel Cabinet is possibly considering an organizational consolidation of these groups, this action would allow processing to be centralized. Further, a single division would provide increased staffing to allow for more definite segregation of processing duties.

Management's Response and Corrective Action Plan

Personnel Cabinet staff in DTS, DEI and LIB all receive HIPAA training and have access to member Personal Health Information (PHI) through their KHRIS access. This requirement is administered at the Cabinet level as opposed to specific business areas.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KEHP-32: The Kentucky Human Resource Information System Does Not Allow Segregation Of Department Of Employee Insurance And Life Insurance Branch Activity (Continued)**

Management's Response and Corrective Action Plan (Continued)

Security roles in KHRIS were designed to meet business requirements during the initial implementation of KHRIS based on knowledge of the software at the time, proposed business processes for the new system and the integration of all benefits in one system in the benefits module as originally envisioned and as the software is designed.

With KHRIS now in production for more than a year, business users and their leadership have a much broader understanding of KHRIS and how their business processes should work within the system. This knowledge is leading to new business requirements for the security roles in KHRIS to ensure proper system controls are in place and business requirements are met. DTS is currently reviewing KHRIS Change Request 23598. This request is for changes to security roles for the benefits users in KHRIS. This change should further define these roles to meet the business need and ensure the security of data in KHRIS.

Combining the two organizational units would not increase the number of employees available for health and life insurance administration. The two programs are quite different—one is self-insured with a TPA and the other is fully insured through a bid contract. The funding streams for health and life are distinct and segregated. Personnel Cabinet leadership does not think that a reorganization combining the two entities would be beneficial at this time.

Your continued efforts to assist in securing the information resources of the Personnel Cabinet are appreciated.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KEHP-33: The Personnel Cabinet Did Not Apply Adequate Logical Security Controls Over The Third Party File Sync Process

Our Fiscal Year (FY) 2012 audit of the logical security controls over the Kentucky Human Resource Information System (KHRIS) system, specifically associated with the file sync process with the Commonwealth's third party health insurance provider, revealed Personnel Cabinet employees have access to state employee's health insurance enrollment data, including third party data, without a documented need.

The Department of Employee Insurance (DEI) has implemented a formal process in order to compare enrollment data captured within their third party's eligibility system to the enrollment data captured within KHRIS and reconcile any discrepancies. On a monthly basis, the third party sends a monthly full sync file to the Personnel Cabinet's Secure File Transfer Protocol (SFTP) server. Once this data is retrieved, designated staff is responsible for comparing the data within the two systems and reconciling discrepancies. The reconciled data is then sent back to the third party provider to 'sync' the two systems. There are three specific folders on this server that house the data used for this reconciliation.

A total of 25 staff within the Division of Financial and Data Services (DFDS), Data Analysis Branch (DAB), and Financial Management Branch (FMB) had access to these three folders and associated data. The Division of Technology Services (DTS) is aware an excessive number of agency staff has access to the third party folders and is currently working to limit access. This access restructuring project is anticipated to be completed by the end of June 2012.

Failure to consistently apply logical security controls could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, and inappropriate or illegal use of system resources.

The foundation of logical security is access control, which refers to how system access is determined and granted to users. Best practice dictates that users are provided access to only those resources necessary to perform their job duties.

Recommendation

We recommend the Personnel Cabinet ensure the access restructuring project currently underway is completed as soon as possible. Access to the share folders should be reviewed on a regular basis to ensure only users with a job duty requirement are granted access. Documentation should be maintained to support the access granted and the business need or justification for such access.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KEHP-33: The Personnel Cabinet Did Not Apply Adequate Logical Security Controls Over The Third Party File Sync Process (Continued)

Management's Response and Corrective Action Plan

As noted in finding, the Department of Employee Insurance (DEI) is working with the Division of Technology Services (DTS) to restructure folders within the share drive across the department. In working through this process and dealing with limitations of share folder structural layout and business needs, DEI's management team has determined that, moving forward, DEI's approach to shared folder structure and policies will adhere to the following rules:

- 1. Because all DEI staff members receive HIPAA training and have access to member Personal Health Information (PHI) through their KHRIS access, all DEI staff will have access to the majority of shared file folders;*
- 2. Some limited access folders will be maintained to house data of a critical business nature; however, the majority of work within DEI will be in shared project folders;*
- 3. Requests for new file folders within the shared folder structure will be controlled by a joint process between DEI's Data Analysis Branch and DTS's Network Services Branch. New folder development will require a manager to describe:*
 - a. Why – What project or person it is for.*
 - b. What – What type of data will be in it, i.e. confidential files, policies, etc, to be used to determine which server/share drive it should be stored on*
 - c. Who – Need to know who should or should not have access to the folder (assuming there is a preference). Include pers# network ID.*
 - d. Duration – is this a temporary measure or a permanently needed folder.*
 - e. Owner – who, within the branch or department, officially owns the folder and can make decisions about contents/location/access if needed.*

While the security process is effective immediately, DTS and DEI are still working through the technical aspects of moving all current file folders into the new shared folder layout for transport to the new server.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KHP-34: The Kentucky Horse Park Did Not Reconcile Bank Statements And Ensure Reconciliations Were Reviewed In A Timely Manner**

During our Fiscal Year 2012 audit of the Kentucky Horse Park, we reviewed controls over bank reconciliations. We judgmentally selected three months of bank statements and reconciliations for the receipt account and the charge card account. Both of these bank accounts are reconciled monthly to account for deposits in transit and outstanding checks. For the months selected, we reviewed all activity in these accounts to ensure the bank reconciliations were performed, reviewed, approved, and unusual reconciling items were explained.

We noted the following findings for the Receipt account:

- The receipts account reconciliation for the month of September 2011 was signed but not dated by the preparer, nor was a review performed by a second person in the business office.
- The January 2012 receipts reconciliation was performed in May 2012. It contained a reviewer's signature, but no date noting when review occurred.
- The May 2012 receipts reconciliation was performed timely, but the reviewer failed to note the date of review.

We noted the following with the Charge Card account:

- The charge account reconciliations for September 2011 and January 2012 were completed; however, the reconciliations were not completed timely. The reconciliation for September 2011 was performed in February 2012. The reconciliation for January 2012 was performed in late March 2012.
- The September 2011 and the January 2012 has not been reviewed by a second person in the business office.
- The reconciliation for May 2012 had not been completed at the time of audit.

If errors or omissions occurred, they would remain undetected when bank reconciliations are not reviewed timely. If the reconciliations do not contain signatures and dates, we cannot verify that reconciliations were performed timely.

Good internal controls require bank accounts to be reconciled in a timely manner. Bank reconciliations should be performed monthly to account for all activity of the organization and should contain the signatures and dates of both the preparer and reviewer.

Recommendation

We recommend the KHP implement procedures to ensure bank reconciliations are performed in a timely manner and contain both the preparer's and reviewer's signature and date to evidence their work.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KHP-34: The Kentucky Horse Park Did Not Reconcile Bank Statements And Ensure Reconciliations Were Reviewed In A Timely Manner (Continued)**

Management's Response and Corrective Action Plan

The Kentucky Horse Park's management agrees with the auditor's recommendation. It is management's intent to implement a policy that incorporates the auditor's recommendations in order to ensure bank reconciliations are performed in a timely manner and contain both the preparer's and reviewer's signature and date to evidence their work.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KHP-35: The Kentucky Horse Park Did Not Pay All Invoices Timely

During the Fiscal Year 2012 Kentucky Horse Park (KHP) audit, we tested a sample of 42 invoices to verify that controls were in place and ensure accuracy and completeness of KHP expenditures. Based on the evidence provided for the sample items tested, we noted 14 invoices that were not paid in a timely manner. KHP incurred \$3,287 in late payments for bills associated with these vendors for Fiscal Year 2012. Late payments are a recurring problem for KHP since the Fiscal Year 2007 audit, and we do not see any indication this issue is improving.

The business office does not receive invoices from the various departments within the park timely and there are a large number of bills to be processed. When the business office receives the bills, they cannot be processed quickly and efficiently due to limited staffing resources.

When KHP does not pay bills in a timely manner, there is a monetary loss to the park through late fees and the vendor customer relationship is strained. Furthermore, failure to record expenditures in the eMARS statewide accounting system in a timely manner could result in misstated expenditures in the financial statements.

Good internal controls require bills to be accounted for and paid in a timely manner to ensure accurate financial reporting. Failure to pay bills timely constitutes a noncompliance with KRS 45.453 which states, "All bills shall be paid within (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agency has transmitted a rejection notice to the vendor."

KRS 45.454 states, "An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of the goods or services or vendor's invoice by a purchasing agency."

Recommendation

We recommend KHP develop and implement controls to ensure all invoices are paid timely as required by KRS 45.453. The procedures should include reiterating to all KHP departments the importance of submitting invoices to the business office when received. KHP should also implement a plan for improving processes in the business office.

Management's Response and Corrective Action Plan

The Kentucky Horse Park management agrees with the auditor's recommendation. It is true that occasionally departments do not submit invoices to the Business Office in a timely manner. Although this has been an ongoing issue, the Business Office believes the instances of late submittal are becoming less frequent. This is because of the regular reminders the Business Office provides. Another reason why some invoices were paid late is a continuing restricted cash flow situation that began in the last quarter of fiscal year 2008. Due to this, some invoices had to be held longer than appropriate. This has been and continues to be an unavoidable problem. The Kentucky Horse Park understands the urgency of paying invoice in a timely manner and is constantly striving to improve this matter.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-36: Kentucky State Treasury's Reconciliation Of The State's Financial System, eMARS, Was Not Completed Timely Throughout Fiscal Year 2012

Kentucky State Treasury's (KST) reconciliation of the state's financial system, eMARS, was not completed timely throughout fiscal year 2012. As of October 2012, KST was completing the April 2012 bank account reconciliations.

KST did not complete timely bank reconciliations during fiscal years 2006 through 2011 which has resulted in a repeat finding. KST had taken tremendous strides on the reconciliation process and was able to catch-up on the reconciliation process at the end of fiscal year 2011. Unfortunately, at the beginning of fiscal year 2012, Kentucky State Government transitioned to a new bank as the state depository bank. As a result of this transition, Treasury was required to once again recreate the bank reconciliation procedures and financial reports used to reconcile the state's accounting system to bank records. These procedures had to be updated again following updates to the eMARS system that took place in April.

When the state's bank accounts are not promptly reconciled oversights, errors, and miscalculations may occur and remain undetected. Ultimately these mistakes could misstate the account balances for financial reporting purposes. Given the volume and size of the receipts and disbursements processed by Treasury, these reconciling items could potentially materially misstate account balances reported in the CAFR.

Examples of errors that are likely to occur include:

- Deposits received at the bank not posted to an agency's eMARS account either due to missing approvals or an error that caused the transaction to be rejected.
- Deposits recorded to eMARS that were not received at the bank.
- Errors in transaction amounts or accounts either in eMARS or the bank.
- Escheat transactions are not reconciled timely between Treasury records and eMARS.

Good internal controls dictate that bank accounts be reconciled in a timely manner. Daily reconciliations should be performed within a few days of the actual occurrence and monthly account reconciliations should be performed within a few weeks of the closeout period at the end of each month. In addition, management's consideration of controls should be updated frequently to account for changes in operating activities, as in the change in banking functions or changes in the accounting system.

Recommendation

Treasury should continue to take appropriate steps to ensure monthly bank reconciliations are performed timely. Going forward, as future accounting system changes occur, we recommend the Finance and Administration Cabinet and Treasury address the impact of those changes on Treasury processes as early in the implementation as possible to avoid significant and prolonged gaps in internal controls.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-36: Kentucky State Treasury's Reconciliation Of The State's Financial System, eMARS, Was Not Completed Timely Throughout Fiscal Year 2012 (Continued)**

Management's Response and Corrective Action Plan

The Treasury Department appreciates the Auditor's recognition of the magnitude of the impact of the system changes which occurred during FY 2012 on the Treasury reconciliation process. Changing to a new depository bank on July 1, 2011, after 85 years with one financial institution, was monumental. Because of the timing of the awarding of the contract, there was very little lead time to prepare. Most of the bank systems were not made known to the Treasury until very shortly before the go-live date. The Treasury Department had to develop and tweak most of its reconciliation programs after the new bank was in place. In addition, the Treasury continued to transact business with the old bank, since outstanding checks continued to be paid on that bank and electronic deposits continued to be received. It was necessary to reconcile accounts at both banks for the entire fiscal year. A substantial setback in reconciliation progress was very much expected because of these changes. Most of the banking system issues associated with the transition have now been resolved.

The eMARS upgrade put into place in April 2012 provided an additional interruption to Treasury reconciliation progress. There were major data disruptions and issues following this upgrade which very negatively impacted the bank reconciliation process. As Treasury moves forward with monthly reconciliation, new data issues resulting from this upgrade continue to arise which must be investigated and explained. As each issue is identified and resolved, the reconciliation process gets closer to becoming a reliable, functioning system once again. No one is more eager to be current with the monthly reconciliations than are the members of the Treasury staff. We look forward to this happening in the near future.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-37: The Kentucky State Treasury Did Not Provide Sufficient Segregation Of Duty Controls Over The Data Processing System**

Our Fiscal Year (FY) 2012 review of the Kentucky State Treasury (Treasury) system controls revealed Treasury did not employ sufficient segregation of duties between the system security administration, operation, programming, and librarian functions in relation to their data processing system. Our testing revealed all critical functions had been granted to a single individual. This individual has unlimited access to every aspect of Treasury's data processing system including management of the use, configuration, functionality, and security of the system. Because of the lack of management oversight related to these functions, there are numerous security controls that could potentially be circumvented without detection. Similar issues have been reported to Treasury since FY 2008.

Of major concern is the fact that this individual had unlimited access to the following production libraries through either a system profile or individual user profile:

- The vendor-supplied library housing all production and test libraries used to perform daily and monthly processing;
- The library housing 'new' objects used to select enhanced Management Administrative and Reporting System (eMARS) data to assist with the monthly reconciliation; and
- The library housing all source code objects used to process the reconciliation programs and generate the monthly reconciliation reports.

This individual had the ability to make any change deemed necessary, without management approval, to system values, user profiles, and critical objects and resource authorities.

Although not functioning as the operator of the main monthly reconciliation program, this individual still acted as the librarian for the library containing the reconciliation programs and was responsible for monitoring a history log for suspicious activity on the data processing system, yet had the ability to alter the data within this log.

Also, this individual, along with two computer operators, had read and write access to a directory on the processing system housing the Automated Clearing House (ACH) file provided by the Finance and Administration Cabinet (FAC), which contains several eMARS electronic fund documents. This file is generated from eMARS production tables, downloaded by the Treasury computer operators from a file transfer protocol (FTP) server and stored temporarily on the data processing system. Once reviewed for dollar value and number of records, the file is transmitted to the bank and then removed from the data processing system. The two computer operators are both responsible for the retrieval of the ACH file from FAC and transmission of the file to the bank; the individual noted above having multiple incompatible duties serves as the backup for the computer operators. Although this is not considered direct access to eMARS production data, it still represents a segregation of duties issue since unauthorized changes could be made to this file within the data processing system prior to transmission to the bank.

It is possible that these segregation of duties issues have existed since the implementation of the data processing system, which dates back to FY 2000.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-37: The Kentucky State Treasury Did Not Provide Sufficient Segregation Of Duty Controls Over The Data Processing System (Continued)

We are aware Treasury has made several requests for additional funding in order to hire another employee with necessary programming knowledge in an attempt to alleviate some of the segregation of duties issues commented on since FY 2008. While these requests have repeatedly been denied, Treasury has not attempted to train current staff on IT-related job duties that could reduce the severity of this issue.

For security purposes, detailed information concerning the specific account profiles and libraries contributing to this finding are being intentionally omitted from this comment. However, these issues are thoroughly documented and have been sent hardcopy to the appropriate agency personnel.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect use of data, programs, and other resources.

Computer programmers should not have direct access to the production version of program source code or be able to directly affect the production environment. The reason for this control is to ensure that the programmer does not intentionally or unintentionally introduce unauthorized or malicious source code into the production environment. Smaller organizations that cannot easily segregate programmer duties from librarian duties should implement compensatory controls to supervise programmer activities to ensure only properly tested and authorized programs are migrated into production.

Programmer duties should not include the migration of programs into production libraries or performing operator procedures such as executing production programs. Programmers should be restricted from the production environment and their activities should be conducted solely on “test” data. This control is designed to ensure an independent and objective testing environment without jeopardizing the integrity of production data.

The same individual should not retrieve the text file with eMARS funding data and also submit that same file to the bank, unless there are compensating controls in place to ensure no changes have been made to the data from the time it was received from FAC to the time it was submitted to the bank.

Recommendation

We recommend Treasury review the current job duties of the individual performing the security administrator, programmer, librarian, and operator function within the data processing system, and determine how these job functions can be redistributed among staff to ensure a proper segregation of duties. Specifically, Treasury should ensure that:

- Someone other than the system administrator, who has unlimited access to the system, be the primary programmer who creates changes within the production programs.
- Someone other than the programmer or operator be required to move changes into the production environment as the librarian.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-37: The Kentucky State Treasury Did Not Provide Sufficient Segregation Of Duty Controls Over The Data Processing System (Continued)**

Recommendation (Continued)

In addition, Treasury should ensure the individual performing the programming function is restricted to a "Read Only" level of access within the production environment (including libraries, files, programs, etc.). The individual responsible for monitoring the history log of suspicious activity should have "Read Only" access to that file.

Based on our understanding of the Treasury staffing limitations and budget constraints, we acknowledge the difficulty in hiring additional staff to accomplish complete segregation of duties. Therefore, our recommendation is focused on the redistribution of certain job duties currently completed by the security administrator among existing staff. We recommend the security administrator select staff members to mentor in security administration and librarian functions with the eventual goal of these individuals taking over these responsibilities. Since the current system administrator has the most data processing system expertise, we recommend he continue to make programming changes. As the security administration and librarian functions are transitioned to other staff, we recommend Treasury work toward establishing segregation of functions as discussed above. With the disbursement of duties among multiple existing staff members, we do not foresee these efforts requiring significant time, thereby allowing staff to also perform their existing routine job duties.

Further, we recommend one computer operator be primarily responsible for the retrieval of the ACH file from FAC and the other be primarily responsible for the submission of the ACH file to the bank. In addition, we recommend the operator sending the file to the bank compare it to the original file downloaded from FAC to identify any changes prior to submission. A log with the date, time, and name of the reviewer should be maintained to document this review. In the event one of the computer operators cannot fulfill his duties, a backup should be appointed to perform his part of the above process.

Management's Response and Corrective Action Plan

The Treasury Department has attempted repeatedly to secure funding to hire the additional staff necessary to satisfy the Auditor's model for a proper segregation of duties in the IT area. The request is made in each budget cycle, using the audit comments as the justification. This request has been repeatedly denied. Without adequate staffing, the type of segregation of duties envisioned by the Auditor will continue to be impossible. The Treasury Department has only one individual with expertise on the AS/400 mainframe. There is no source of funding for an additional person, and no position available under the personnel cap.

The System Administrator will initiate a plan to mentor Treasury's office Network Administrator in the function of librarian for the AS/400. That person, however, does not have any formal AS/400 training and is stretched very thin with other office duties.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-37: The Kentucky State Treasury Did Not Provide Sufficient Segregation Of Duty Controls Over The Data Processing System (Continued)**

Management's Response and Corrective Action Plan (Continued)

Although it might be theoretically desirable to have one computer operator be responsible for the retrieval of the ACH file from FAC and the other be primarily responsible for the submission of the ACH file to the bank, in the real world this is not feasible. The Treasury only employs two computer operators, and there are many instances in which both operators are not in the office at the same time. The Treasurer's Office makes certain that there is a computer operator present at all times during working hours to transmit ACH files and to print any checks which are scheduled to go out. With current staffing, however, it is impossible to insure that there are always two operators available. The operators sometimes work different hours, one coming in very early in the day to begin printing checks and transmitting available files, and one staying late to process any end of day payments. The ACH files scheduled to go out are extremely time sensitive and cannot wait for a second person to come in to complete the send process. The file transmissions occur many times daily. The only backup to this process who could be called on if both operators were not present would be the System Administrator, who has already been identified by the Auditor as "having multiple incompatible duties . . ." In many instances he is not available, either. There are simply not enough people working in the Data Processing Division to turn the transmission of daily ACH files into a two person process. The risk of changing an ACH file as it momentarily passes through the Treasury Department is infinitesimal. This is a risk that will have to be assumed and managed since the personnel are not available to provide the level of segregation of duties desired by the Auditor.

Auditor's Reply

We acknowledged Treasury's past attempts to gain funding for an additional position within the condition of the comment. However, given the fact that Treasury is repeatedly denied funding for such a position, we would encourage Treasury to consider other compensating controls to ensure the data processing system is properly secured. We have made reasonable suggestions within the recommendation of the comment that would address the weaknesses identified in the finding. Further, we have informed Treasury that the IT Audit staff is available to help brainstorm and assist Treasury with this process as much as possible.

In an attempt to assist Treasury in explaining the need for another IT/Programmer position or to implement compensating controls, the reader should be aware of the significant impact of this finding. Without this funding, Treasury is extremely limited as to what can be accomplished since there is only one individual with working knowledge of the data processing system. This individual is responsible for all aspects of security, which is typically not seen or allowed in other agencies. While we have recommended Treasury implement compensating controls to address these concerns, the ability to add an additional IT position, when feasible, would be the best approach to adequately address our security concerns.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-37: The Kentucky State Treasury Did Not Provide Sufficient Segregation Of Duty Controls Over The Data Processing System (Continued)**

Auditor's Reply (Continued)

Further, Treasury's willingness to mentor the current Network Administrator to serve as the data processing system librarian should be commended. This individual should begin receiving training immediately. We believe this will assist in alleviating some security concerns associated with the security administrator. We would encourage Treasury to also mentor this individual in other aspects of security surrounding the data processing system. We understand that this individual may not have extensive knowledge of the data processing system; therefore, training him/her in this role will take some time. However, we would encourage Treasury to start with less complex functions such as user access. More complex functions could then be added as the individual becomes more familiar with the system including managing security over system values, critical libraries, system commands and utilities, and files and programs. We further encourage Treasury explore options of establishing independent system administrator and programmer functions using current staffing.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-38: The Kentucky State Treasury Did Not Develop And Implement An Application Security Policy Related To The Data Processing System

The fiscal year (FY) 2012 audit of application-level security over the Kentucky State Treasury (Treasury) data processing system revealed Treasury did not have written security control policies or procedures in place concerning critical functionality on the data processing system. Of greatest concern is the lack of management-defined security controls related to critical utility programs, commands, libraries, and objects such as programs and files residing on the data processing system. Similar issues have been reported to Treasury since FY 2008.

Treasury created an Information Technology (IT) Security Access Request Policy; however, this policy only discusses the process to request access to the network and data processing system. Additionally, Treasury employs an operator's guide for the data processing system, developed individual procedures related to physical security and contingency planning, and adheres to the Commonwealth Office of Technology (COT) Anti-Virus Policy CIO-073. However, none of these policies specifically discuss security controls for the critical aspects of the data processing system.

By not adequately documenting, implementing, or communicating acceptable application security policies and procedures management and users may lack an understanding of security related issues. This lack of understanding could potentially result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system functionality or resources. Additionally, it increases the likelihood of unauthorized or inaccurate data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources.

We are aware Treasury is a small organization with limited staff; however, it is management's responsibility to ensure strong security controls within its organization. Formal policies should be established specifically addressing security controls over critical utilities, commands, libraries, and objects to help ensure only authorized access is granted to these resources and appropriate actions can be taken against Treasury's data processing system. Consistent application of formal security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls.

Recommendation

We recommend Treasury develop formal policies and procedures to administer the security of their data processing system. The system security policy should include:

- functional and technical requirements;
- management's objectives and expectations for information security in clear, unambiguous terms, along with the implications of noncompliance;
- key risks and mechanisms for dealing with those risks;
- roles and responsibilities of management and users;
- a process for regular monitoring and feedback to ensure the policies are enacted and enforced;
- flow charts of the system and interfaces;
- end user accountability and acceptable use;

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-38: The Kentucky State Treasury Did Not Develop And Implement An Application Security Policy Related To The Data Processing System (Continued)

Recommendation (Continued)

- policy for enabling auditing and frequency of review;
- listing of critical libraries, commands, utilities, and objects and authority that should be established over them;
- references to the operator's guide; and
- references to the physical security, contingency planning, and anti-virus procedures.

These policies and procedures, once developed, should be properly distributed and all necessary system users made aware of their responsibilities. Further, management should ensure the consistent application of these procedures.

Management's Response and Corrective Action Plan

The Kentucky State Treasury appreciates the opportunity to comment on the issues addressed, to more accurately describe operations and clarify, if not expand the view of the auditor.

Since the introduction of computing technology to the Treasury in the early 1960s, audits focusing solely on information technology are a new occurrence. In fact, no previous Treasury administration has been subjected to that level of internal security review. In essence this administration has been asked to address compliance issues that have never been addressed and then develop the policy and modify the procedures to move the Treasury to the most current best practices. Compounding the challenge, Treasury has been asked to accomplish this task with very few resources. Treasury's budget has been cut by more than 25% since SFY 2008, due to the largest economic downturn since the great depression.

We draw attention to these facts to bring some historical perspective to the Information Technology Audits and to call attention to the amount of work we have accomplished in a historically short period of time (since 2008), with no additional resources. More importantly, we wish to emphasize to the reader that Kentucky State Treasury has extensive security practices in place and that the Commonwealth fiscal systems are secure. Please note the concern of 12-KST-38 regards the expansion of current written policies that the APA auditor believes are not comprehensive enough.

In short, the APA auditor is asking for more extensive documentation of every programming change, to meet a best practices standard. That level of documentation is time consuming and Treasury has a programming staff of just one (with a full workload). (Please see the Recommendations section of 12-KST-38 for a full listing of the additional documentation.) To meet the mandated standard there are associated costs they are discussed below.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-38: The Kentucky State Treasury Did Not Develop And Implement An Application Security Policy Related To The Data Processing System (Continued)

Management's Response and Corrective Action Plan (Continued)

Treasury maintains the position to attain this "best practice" for policy scope and the associated documentation that the APA auditor is mandating, we require at least one additional IT staff at cost of more than \$50,000 per year. Treasury has pressed our case, but we have not been successful in obtaining the added staff and as such the a APA auditor's recommendation to expand our policies and procedures becomes a longer-term goal.

To highlight our request for added resources and address the APA auditor's concerns, Treasury has for the last two biennial budgets attached a copy of the APA audit findings to our budget requests. We were partially successful in the STY 2011-13 budget process, securing an IT position to the biannual budget narrative. However, no funding was provided by the legislature to staff that position.

The Kentucky State Treasury believes Information Technology security policy is of critical importance for the protection of information and fiscal transactions. We have been very mindful of the APA auditor comments and recommendations. Since 2008 Treasury staff have been dutifully addressing the concerns noted by the APA auditors. Our current commitment to implementing "best practices" remains steadfast and our past efforts will be extensively documented later in this response.

Treasury would like to address the APA auditors inference regarding the wording of 12-KST-38, in particular the narrative, "did not have security control policies or procedures in place concerning critical functionality of the data processing system" and specifically, the "lack of management defined security control related to critical utility programs, commands, libraries and objects such as programs and files resting on the data processing system." Treasury finds the statements misleading. Treasury has many policies in place and we appreciate the APA auditor's notation of that work in past audits and in the current audit. For example:

- *"Treasury created an Information Technology (IT) Security Access Request Policy (12-KST-38),*
- *Treasury employs an operator's guide for the data processing system (12-KST-38),*
- *Treasury developed individual procedures related to physical security and contingency planning (12-KST-38).*
- *Treasury developed a System Values Change Requests policy..."*

Treasury can cite additional examples of our efforts to develop written policies that were not included in the APA auditor's comments.

When Treasury began the development of the IT policy documentation, we made clear, due to lack of staffing that it is an ongoing process. In fact, the best documentation of our position is our response to last year's (2011) comment regarding this same issue,

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-38: The Kentucky State Treasury Did Not Develop And Implement An Application Security Policy Related To The Data Processing System (Continued)

Management's Response and Corrective Action Plan (Continued)

"... The Treasury Department will continue to work toward the development of a formal policies and procedures manual to be used to administer the security of its data processing system. The system security policy envisioned by the Auditor is comprehensive and detailed, and will involve a major time commitment. With the very limited staff available, and with the current on-going projects, including bank reconciliation, the conversion to the new bank and the implementation of the new statewide payroll system, which are critical to the daily operations of the office, this comprehensive security policy cannot receive very high priority at the current time. It will remain an important long-term goal of the Treasury Department's Data Processing Division. This detailed policy will also be dependent upon the completion of the examination of the libraries and the objects associated with the Treasury computer system, which are discussed in other audit comments. With the magnitude of this total project, it is not something that will happen quickly.

As Treasury has noted previously and the APA auditor currently notes we have few resources to address this issue... ' We are aware Treasury is a small organization with limited staff...' With the efforts we have made in the past and our continued commitment to enhancement, Treasury finds a discord with the implicit tone of 12-KST-38; that is, Treasury has been ignoring the APA auditor's finding. We again reference paragraph number four (4) of this narrative and cite an additional example in the Recommendation section of a separate finding. The narrative begins with the following, "We recommend Treasury develop formal policies and procedures to administer security of the data system." The APA auditor's comment implies that Treasury does not have any policies. And when coupled with the statement by the APA auditor, "Similar Issues have been reported to Treasury since FY 2008," to even the educated reader of 12-KST-38 it implies Treasury is ignoring that problem. Neither implication is accurate. The facts are, Treasury has policies in place. Treasury continues to add and enhance both policy and procedures. Treasury's goal is to achieve the industry best practice standard requested by the APA auditor.

Work Plan:

The Kentucky State Treasury has aggregated, formalized and implemented enhanced written security policies for the SFY 2013. The document is titled the Security Standard Procedures Manual. The document addresses many (if not all) of the concerns that the APA auditor finds lacking in Treasury's current written policies regarding application security. Please note this document is a work in progress. During the next fiscal year (and beyond) Treasury will be adapting and documenting our operational practices for addition to the manual. We look forward to your review of the document next year and again express our commitment to the development, implementation and refinement of Treasury's IT policies and practices.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-38: The Kentucky State Treasury Did Not Develop And Implement An Application Security Policy Related To The Data Processing System (Continued)**

Auditor's Reply

Though Treasury developed an Information Technology (IT) Security Access Request Policy and operator's guide, they have not documented policies or procedures that address security controls for the critical aspects of the data processing system. We did not explicitly state that Treasury is ignoring or disregarding our finding related to application security policies as was referenced in Treasury's response. However, the IT Security Access Request Policy, which was developed on August 25, 2009, is a three sentence policy that is extremely vague in nature and has not been updated since this time. It does not provide specific details about requesting, approving, and granting access to the data processing system, which we have repeatedly recommended Treasury include within the policy. During the FY 2013 audit, we will request a copy of the Security Standard Procedures Manual to determine if it addresses all concerns associated with application security.

Further, we recognized the fact that Treasury is a small organization. However, management has not trained any additional staff to assist the system administrator; thereby relieving him of extra job duties that we repeatedly address as segregation of duties issues.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-39: The Kentucky State Treasury Did Not Expand And Strengthen Formal Program Change Control Procedures

Our Fiscal Year (FY) 2012 audit of system controls revealed weaknesses regarding the program change control procedures of the Kentucky State Treasury (Treasury). During FY 2010, Treasury implemented a Programming Requests Policy governing controls for program development and modifications of data processing systems. However, the policy did not adequately address all phases of the program change control process. Similar issues have been reported to Treasury since FY 2008.

The Programming Requests Policy dictates that all programming requests for new development or modification to existing systems be discussed with the appropriate Division Director. Once there is justification for the change request, the Division Director makes a formal request by email to the Information Technology (IT) Division Manager. The requests are then reviewed for feasibility by the IT Division Manager and either approved, returned for more information, or rejected with explanation. Although not specified in the policy, the IT Division Manager stores all requests in a Microsoft Outlook folder.

The Programming Requests Policy is a general statement and does not contain specific requirements related to the following areas:

- Supporting content of the initial request email;
- Testing of program changes prior to submitting to production;
- Approval to move to production;
- Final acceptance notification;
- Retention of all documentation supporting change, including request emails, testing documentation, approval documentation; and
- For new program development, the creation and retention of program specifications and other related technical documentation.

Due to changing the financial institution providing the Commonwealth's banking services in FY 2012, the auditor reviewed the primary program used to perform the monthly reconciliation, which revealed 122 out 305 lines of program code that was changed affected processing. A formal memorandum was on file requesting changes to the reconciliation program based on the change in banking services. Further, Treasury management acknowledged in the memorandum that some changes would have to be made on-demand, which would prevent adequate documentation associated with the change to be maintained. Although not specifically required by the current policy, due to the magnitude of changes being made, we would have anticipated seeing documentation to show testing of the changes, approval to move the changes from testing to production, and final approval that the changes were working as expected in production.

Without specific and detailed program change control procedures, management increases the risk of developing and implementing ineffective or inaccurate systems and the risk of unauthorized changes being placed into the production environment that have an adverse affect on system processing results.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-KST-39: The Kentucky State Treasury Did Not Expand And Strengthen Formal Program Change Control Procedures (Continued)

Policies and procedures ensure that an organization's program change control methodology applies to the development of new systems and programs, major changes to existing systems and programs, and user participation. Program change control procedures require adequate program specifications be provided to a programmer prior to program development to mitigate processing errors and the need for numerous program modifications. Sufficient procedures dictate that complete and accurate system documentation be developed and maintained for all critical systems, as this information is vital to ensuring longevity of the system. Program change control procedures must be consistently applied and include adequate procedures to segregate the live production environment from development and testing environments. They should also be distributed to all key personnel to ensure consistent implementation of new systems.

Recommendation

We recommend Treasury expand their current Programming Requests Policy to ensure all steps of a complete program change control process are adequately defined. Regarding the formal request by email, the policy should state the requirement of the emails to include as much information as possible concerning the problem identified and the proposed correction or update. The programmer should then document, at a minimum, the following:

- the necessity for the change;
- the affected system(s); and,
- the program and/or report the change will affect.

We also recommend the following expansion of the procedures in order to strengthen the Programming Requests Policy:

- add requirement to retain all documentation supporting the change, including requesting a change, testing documentation, and approval documentation within the specific retention location;
- add requirement to test program changes prior to submitting to production;
- add requirement for approving changes to be implemented in production;
- add requirement for a final acceptance notification from requestor accepting changes after moved to production; and
- add requirement for new program development related to the main accounting/reconciliation system to create and retain detailed program specifications and technical documentation.

Once these changes have been made to the Programming Requests Policy, Treasury should provide this information to all appropriate staff and ensure strict adherence to the policy going forward.

All documentation related to a change should be maintained and made available for audit purposes.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-39: The Kentucky State Treasury Did Not Expand And Strengthen Formal Program Change Control Procedures (Continued)**

Management's Response And Corrective Action Plan

The Kentucky State Treasury appreciates the opportunity to comment on the issues addressed, to more accurately describe the system in question and clarify, if not correct, the view of the auditor.

The Kentucky State Treasury would like to address an issue requiring clarification, specifically the need for documentation for each phase of the computer programming process. Treasury wishes to emphasize that the example cited by the APA auditor was a one-time situation. Please know, the Treasury programmer followed the policy in effect at that time and received approval from the Deputy State Treasurer. He was authorized to develop and implement the changes needed to ensure a smooth transition to the new correspondent bank. The programmer had complete authorization and was not required to make separate requests for each development phase. In fact, it is noted by the APA auditor that programming changes authorization for on-demand changes would be required and were duly authorized.

This necessity for this one-time authorization was the change to the Commonwealth's correspondent bank contract. A new provider won that contract and Treasury was now required to make the associated modifications to accommodate the new bank partner. The contract was not awarded until March of 2011. This left Treasury just three months to develop the programming for the mandated implementation on July 1, 2011. The programmer was provided more lenient authorization due to the implementation time-frame now imposed on the Treasury. So, in this example Treasury specifically gave authorization to the programmer, so he would not have to document each program change. If the programmer had spent his time documenting each programming effort, the transition would have fallen behind and been unsuccessful.

Subsequent to implementation of the new programming, Treasury management requested a listing of that production library. We have reviewed the 127 programs developed for that project. We found no areas of concern. This was not the level of authorization that we would look to in the future, but it was what was feasible under extremely limiting circumstances. Again, for the change policy in place at that time, all programming was authorized.

In 2012 the Kentucky State Treasury developed enhanced security policies which included a more comprehensive change request policy. The policy change became effective July 1, 2012. The enhanced policy (and the change request form) include the topics requested by the APA auditor. The expanded documentation will be ready for review in 2013. The Kentucky State Treasury is hopeful the additions will fulfill the logical security control addressed in 12-KST-39.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-KST-39: The Kentucky State Treasury Did Not Expand And Strengthen Formal Program Change Control Procedures (Continued)**

Auditor's Reply

We acknowledged the change in banking providers, which resulted in the significant number of program changes during FY 2012. While these changes were authorized by Treasury's management, there was not documentation on file to show that these changes were properly tested prior to being moved to production. Also, the Programming Request Policy, which Treasury developed and formalized during FY 2010, has not been updated since August 2009. It is a three sentence policy that is extremely vague and does not include sufficient details to explain all aspects of the change process. We will request the enhanced security policies currently being developed by Treasury during the FY 2013 audit to determine if the documented procedures address all security concerns associated with program change management.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PARKS-40: The Department Of Parks Receipt Transactions Were Not Deposited Timely

During the fiscal year 2012 audit of the Department of Parks (Parks), the auditor tested 60 receipt transactions and found ten exceptions to the timely deposit and recording of daily receipts:

- One Exception: Electronic transfer of receipts to the State Depository was not made within five days of deposit to the local area bank account for the Park. This transaction was posted 11 days after deposit to the bank.
- Two Exceptions: Park did not deposit day's receipts to the local area bank timely. These deposits were made five and two days after receipt by the park.
- Four Exceptions: Park did not record day's receipts to eMARS via JV2P within one week of the date received. On average the JV2Ps were completed 11 days after receipt.
- Three Exceptions: Cash Count Sheet did not document the count of two separate individuals as required. Further, in one instance the Cash Sheet was not signed by anyone. Initials were typed in.

Delays in depositing cash and checks and recording these transactions increase the possibility of theft. Delays in making ePAY transfers to the general fund and preparing documents to record the deposits to eMARS increase the likelihood of mistakes due to human error.

Failure to complete the cash counting process and document that at least two separate individuals counted the cash and verified the cash deposit agreed to the DBR, could lead to bank errors and eliminates a valuable internal control over the kiting of cash.

Given current economic constraints, Parks depends on funds collected from guests at the state park level. All delays to the deposit and recording of these transactions prevent Parks from having an accurate record of available funds and may impact their ability to promptly pay vendors. Failure to verify the accuracy of the deposit could lead to the loss of revenues through error or fraud.

Per the Department of Parks Business Procedures Manual:

- Deposits for each day will be kept separate and each day's receipts must be deposited intact. Deposits should be taken to the local bank no less than on Mondays & Fridays." (Section 4- "Change Fund - Cash Receipts - Cash Control")
- Two signatures must be obtained for the Daily Cash Log to document that a separation of duties is being achieved. (Section 6 - "Daily Business Report"- "New Daily Cash Log Instructions")

Good internal controls dictate that the state's accounting system (eMARS) be updated timely and accurately to reflect the funds available to Parks and allow for accurate reporting.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PARKS-40: The Department Of Parks Receipt Transactions Were Not Deposited Timely (Continued)**

Recommendation

We recommend Parks follow its written policies regarding the timeliness of cash deposits and the recording of these transactions to the state's accounting system and reemphasize the importance of timely deposits.

Management's Response and Corrective Action Plan

We agree with the assessment and in most of these instances the delay in making deposits to the local bank and processing of e-PAY's were a result of the weekends or staff shortages due to the reduction in hours and budget limitations. We have and will continue to stress to parks management the importance of following the Business Procedure Guidelines with regards to the timeframes required for processing DBR's, deposits and e-PAY's.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PARKS-41: The Department Of Parks Did Not Maintain Adequate Documentation For All Expenditures**

During tests of Parks expenditure documents, we found 11 exceptions related to inadequate documentation for expenditure transactions.

- Four Exceptions: Supporting documentation did not provide evidence of prior authorization of the purchase per park policies.
- One Exception: Invoice was not itemized and did not provide evidence of what was actually purchased. Only purchase evidence provided was a payment receipt from a credit card payment, which only documented the total payment amount.
- One Exception: Supporting documentation did not provide adequate explanation for the write-off of an account receivable.
- Five Exceptions: Supporting documentation did not support or document a business purpose for the items purchased.

The prior approval of expenditures ensures that adequate funds exist for purchases and that management concurs with the necessity of purchases. Budgetary restraints have forced many state agencies including the Department of Parks to reduce expenditures. Not adhering to the required prior approval of expenditures could result in unnecessary expenditures or purchases that exceed a park's available funds.

Documenting the purpose of expenditures at the time of purchase prevents the purchase of unnecessary items and ensures that information is readily available for future review.

Parks business procedures require that purchases in excess of \$250 at park facilities receive prior approval from the appropriate central office purchasing staff. All expenditures at park facilities must also receive prior approval of the park manager.

Good internal controls dictate that itemized invoices and other documentation explain the purpose of expenditures be documented so that any reviewer could understand the necessity of the purchase.

Recommendation

We recommend Parks review this procedure with purchasing staff at Parks' facilities and ensure that purchase approvals are documented with the supporting documentation of all purchases. Those not following this policy should be disciplined as outlined in Parks Business Procedures Manual.

Documentation of the business purpose of expenditures should be reinforced with Parks' staff. Postage, for example, is generally a necessary expenditure, but is also something that could easily be transferred to personal use. The purpose of each postage purpose should include at minimum a brief explanation such as "mailed 7-12-12 DBR to Central Office" or "personal items to customer (folio #)."

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PARKS-41: The Department Of Parks Did Not Maintain Adequate Documentation For All Expenditures (Continued)**

Management's Response and Corrective Action Plan

New purchasing guidelines are being sent to all employees and this will serve as a reminder and educate staff of the appropriate process and procedures for making purchases. These new guideline will address instances such as the four exceptions that did not provide evidence of prior authorization.

The one exception that did not include an itemized list of items purchased was because the vendor did not provide one to the employee making the purchase. We have sent out additional pro card guidance to educate staff of what should be submitted after a purchase has been made.

In regards to the 5 exceptions for supporting documentation not supporting or documenting a business purpose for items purchased it was deemed during our audit of the transactions that they were within our normal scope of business. At this time, while we do require a description of the item, we do not require a business purpose. We will discuss the added value of this step and consider it in future procedures.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PARKS-42: The Department Of Parks Payroll Documentation Did Not Include Required Approvals Or Fully Support Expenditures**

During testing of payroll expenditures for the 2012 fiscal year, the auditor noted the following exceptions:

- Twenty instances where a timesheet or timecard was not signed by the employee, supervisor, or both.
- Fifteen instances where prior approval of overtime was not documented.
- Four instances where the KHRIS timesheet did not agree to the employee's timecard.

We also noted 21 of the 39 exceptions occurred after December 2011, when we issued a similar audit finding for FY 2011, which Parks indicated they would correct.

Expenditures including payroll should be supported by documentation that agrees to the amount paid for that expenditure. Due to the errors and omission described above these payroll expenditures were not adequately substantiated by the documentation including timesheets, properly approved leave requests, and overtime forms.

Good internal control over payroll dictates that payroll charges should be supported by adequate documentation including signed timesheets or timecards, leave and overtime forms that detail and substantiate hours and times worked by each employee.

Recommendation

We recommend Parks review established standards for recordkeeping including requirements for the use of leave and overtime approvals and ensure that procedures are uniform across all Parks facilities. In addition, Parks should consider establishing a periodic review of payroll at each park that includes agreeing timecards and other supporting documents to ensure that they support payroll and are completed per the established guidelines.

Management's Response and Corrective Action Plan

During testing of payroll expenditures for the 2012 fiscal year, the auditor noted the following exceptions:

- *20 timecards or timesheets that were not signed by either the employee, their supervisor or both.*
- *15 instances where there was no documented approval of overtime worked*
- *4 instances where the KHRIS timesheet did not agree with the timecard.*

Payroll HR Administrator, HR Specialist III, and I reviewed the exceptions and agree with the findings.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PARKS-42: The Department Of Parks Payroll Documentation Did Not Include Required Approvals Or Fully Support Expenditures**

Management's Response and Corrective Action Plan (Continued)

I am in the process of contacting each park manager that had exceptions, to review with the managers the exceptions for their park. As stated in the 2012 Audit, the findings were similar to the findings to the 2011 audit. I want to reiterate, as the 2012 Audit stated, 17 of the exceptions were prior to the DOP receiving the findings of the 2011 audit in which it was recommended to DOP to have employees sign both the timecards and the KHRIS timesheets. Prior to the 2011 audit DOP was not requiring employees to sign the KHRIS timesheet as the HR Generalist were transferring the hours from the signed timecard to the KHRIS timesheet. Most of the 17 exceptions were unsigned timesheets that were dated prior to my instructions requiring that all employees and supervisors are required to sign all KHRIS timesheets. However, as the 2012 Audit stated, 24 of exceptions were after my instructions. Therefore to ensure that the Department of Parks adheres to the payroll procedures and are in compliance in the future I plan to take the following steps:

I will communicate the findings with all Park Managers, Business Managers, and HR Generalists (HRG's) and reiterate the importance of adhering to park policies and procedures. I will send each HRG a copy of the Payroll Procedures for review.

I will set up a meeting with HRG's and Business Managers of the parks that had exceptions on the 2012 Audit, to review their specific processes and to resolve any payroll issues or problems they are having that may be contributing to the errors.

I will put all park managers on notice that since these are similar finding to the 2011 Audit, the Department of Parks (DOP) will conduct follow up audits to ensure all policies and procedures are being adhered to and that the DOP will take appropriate action if the deficiencies are not corrected.

I will meet with the DOP Internal Audit Branch to review the findings and request that a follow up audit is done in 3 to 4 months on each of the parks that had exceptions to ensure payroll policies and procedures are followed. This review will include agreeing timecards and other supporting documents to ensure that they support payroll and are completed per the established guidelines.

I will continue to reiterate the importance of checking payroll information for proper signatures and supporting documentation, and maintaining this documentation properly. We will instruct Park Managers to review the payroll procedures and recordkeeping requirements with their payroll officers to ensure compliance.

The Parks audited that had exceptions were EP Tom Sawyer SP, General Butler SRP, Pennyrile Forest SRP, Dale Hollow SRP, Yatesville Lake SP, and Jenny Wiley SRP.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PARKS-42: The Department Of Parks Payroll Documentation Did Not Include Required Approvals Or Fully Support Expenditures**

Management's Response and Corrective Action Plan (Continued)

The Department of Parks currently has a park policy that requires employees and supervisors to sign all timecards as well as initial any times written in or any changes made to the time card. Park Policy also requires employees to utilize the Leave/Compensatory Form for all leave time and compensatory time earned and used. On December 13, 2012, I sent a memo, via email, to all park managers, business managers, and payroll officers reiterating established standards for recordkeeping including requirements for the use of leave and overtime approvals to ensure that procedures are uniform across all DOP facilities. I reiterated that although an employee may be scheduled on a holiday, they still are required to complete a Leave/Compensatory form since the employee will earn compensatory time for working the holiday. I reiterated that supervisors must show on the Leave/Comp form that the leave was approved in advance, by signing or initialing the Leave/Comp form for each occurrence and that it is not acceptable to just sign the bottom of the form. Park Policy 01-01, instructing park managers/payroll officers to review with supervisors and employees the payroll policies as well as the types of errors that were found to ensure that all employees are fully aware of the payroll policies and to ensure that payroll officers are reviewing employee payroll more carefully. I do believe that our payroll officers and managers have a good understanding of the payroll process. However when transferring payroll data from employee time cards to the official KHRIS timesheets, the HRG's are not taking the necessary steps to follow up and ensure that the timesheets are being signed by both the employee and the supervisor. They need to review the payroll more closely and catch these types of errors.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-43: The Personnel Cabinet Did Not Ensure Sufficient Authentication Is Required To Access Potentially Sensitive Information

While performing the Fiscal Year (FY) 2012 security vulnerability assessment for the Personnel Cabinet (Personnel) machines, we discovered one machine where administrative consoles were accessible with no authentication, which could lead to an unauthorized user gaining full access and control of the system. This issue was brought to management's attention on May 4, 2012. The issue was addressed immediately and resolution was confirmed on May 7, 2012.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

If a machine is not properly configured to allow only authorized users access to the service, the risk of intentional or unintentional modifications to system data and resources is increased.

Services running on agency machines should be properly configured and default accounts should be disabled to ensure unauthorized access is prohibited.

Recommendation

We recommend the Personnel Cabinet periodically review services on network machines to ensure they are restricted to only those users with a documented specific, business related need. If a service is determined not to have a specific business purpose, it should be disabled. For those services that do have a business purpose, authentication features should be reviewed to ensure that they are configured to restrict access to only users who have a need for the service.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates the Auditor's Office's additional work to secure our network resources. Technical leads in the Division of Technology Services have reviewed the machine identified from the recent vulnerability scan regarding this formal comment. This server acts as a Java web server where the FileNet Image Services Resource Adapter (IRSA) software and the Java based Image Connect software reside.

Management installed this application because it has a minimal cost, it is widely used, it has excellent documentation, and it was able to be installed without external support. The JMX Console is the Management tool set that provides a raw view of the JMX screens which make up the server. They can provide a lot of information about the running server and allow you to modify its configuration, start and stop components as needed. This application was disabled in May 2012.

Further, this proprietary device has no domain rights to the Personnel Cabinet network. All devices noted are now blocked from external access through the Personnel firewall. Thank you for your continued efforts in scanning mission critical systems to secure the information resources of the Commonwealth.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-44: The Personnel Cabinet Did Not Maintain Current System Documentation To Support Processing Performed By The Kentucky Human Resource Information System**

Our Fiscal Year (FY) 2012 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resource Information System (KHRIS) revealed Personnel did not maintain documentation describing critical processing performed by the system. This issue was originally reported on during our prior year review.

KHRIS is the software system used to manage human resource data for the Commonwealth of Kentucky. The KHRIS system was implemented on April 1, 2011. Various modules and components are used to process payroll, personnel administration, life and health benefits, and time administration within KHRIS. While there are numerous Business Process Procedures (BPP) available on the Personnel Cabinet's website to assist users with maneuvering through the system in order to perform daily tasks, there are no manuals or other documented procedures that reflect how payroll is processed within KHRIS once time is entered. Specifically, we could not determine how the time entered on timesheets and information in the associated Infotypes is used to process payroll. The Infotypes we believe to be used in this process would include recurring payments/deductions, basic pay, bank details, etc.

Personnel has developed a time schema manual, which is in draft format. This manual provides useful information related to the time evaluation process. However, other critical Human Capital Management Processing (HCMP) procedures, including processing of personnel actions to the final Personnel Action Notifications (PANs), have not been documented.

Further, system edits and audits have been built into the configuration of the system. Solution Manager is an application housing technical and functional documents which supports the current configuration and programming logic associated with KHRIS. Review of the documentation specifically associated with personnel and payroll data revealed 53 of 327 documents, or 16.2 percent, had no date on them; therefore, the auditor could not determine when they were developed or if they reflect current processing. Further, 210 of 327 documents, or 64.2 percent were outdated or still in draft format. We defined files as outdated if they had not been updated on or after April 1, 2011, when KHRIS went into production.

In addition, design documents associated with the Operations Management System (OMS) interface indicate error reports are generated; however, there were no actual error reports generated by the system. Kentucky Transportation Cabinet (KYTC) and Personnel Cabinet staff confirmed errors are actually captured via output screens at the time of processing.

Lack of documentation increases the likelihood of erroneous or incomplete processing. It further increases the likelihood of unauthorized or unintentional data modification, destruction of assets, and interruption of services.

Proper documentation should be maintained for each critical program in production in order to, at a minimum, identify the purpose of the programs, the origin of data, the specific calculations or other procedures performed, and the output of data or reports.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-44: The Personnel Cabinet Did Not Maintain Current System Documentation To Support Processing Performed By The Kentucky Human Resource Information System (Continued)**

Recommendation

We recommend Personnel develop a manual similar to the time schema for time evaluation to ensure users are aware of how the time entered on timesheets and information in the associated Infotypes are used to process payroll. Also, a similar document should be developed to describe all other critical human resource processing. Specifically, this should address the creation, processing, and approval of personnel actions that lead to PAN documents.

We also recommend Personnel perform a review of all technical and functional documentation available within the KHRIS Solution Manager application, making necessary updates to accurately reflect current processing and program logic. Further, all technical documents associated with OMS should be updated to accurately reflect how errors are generated and displayed. The individual responsible for updating the documentation should properly identify each change and provide a date in which the update was made, or the date of the last review, if no changes were required. These documents should be updated on a regular basis going forward, or as necessary based on changes made to KHRIS processing.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates the Auditor's Office's comments and recommendations in regard to proper documentation for critical programs in KHRIS. The Division of Technology Services (DTS) agrees that proper documentation is a critical system control and will continue to build on the progress already made in regard to KHRIS documentation of critical programs such as the Payroll and Time Schema documents already shared with the Auditor's Office during this audit.

DTS will be working with the Division of Employee Management to create a system document of all personnel actions in KHRIS that ultimately lead to the creation of the PAN as the output document of all personnel actions.

The Time Evaluation processes contained within SAP is proprietary code that uses the rules provided by the documented schema to process keyed time. DTS can provide basic instruction on how time is processed based upon attendance and leave keyed, but to provide documentation of the actual evaluation code is not possible. DTS can provide a link to SAP's website for further information regarding time evaluation.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-44: The Personnel Cabinet Did Not Maintain Current System Documentation To Support Processing Performed By The Kentucky Human Resource Information System (Continued)**

Management's Response and Corrective Action Plan (Continued)

DTS is in the process of performing a review of all functional and technical specifications in Solution Manager and is making updates accordingly which will include documentation on the OMS program. Many of the aforementioned specifications did contain only the 'draft' revision dates; however, they do reflect current system functionality. The functional and development teams are currently responsible for updating the specifications or configuration documentation when appropriate as part of the DTS Change Control process.

Thank you for your continued efforts to ensure proper system controls such as documentation of all critical programs in KHRIS.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-45: The Personnel Cabinet Did Not Ensure Processing Associated With The Kentucky Human Resource Information System Functions As Intended**

Our Fiscal Year (FY) 2012 audit of the Personnel Cabinet (Personnel) revealed certain processing functions associated with the Kentucky Human Resource Information System (KHRIS) were not functioning at implementation as originally designed. State agencies have experienced problems with KHRIS processing since implementation on April 1, 2011.

As noted during our prior year audit, we found employee pay rates were not calculated consistently within KHRIS. According to the Human Resource Generalist (HRG) Training Manual, the following information is required based on Time Management (TM) Status and Time Card Rule:

- When TM Status 1 (Actual Times) and Time Card Rule 1 (Time Card Required), time must always be keyed or an individual will not get paid.
- When TM Status 9 (Planned Times) and Time Card Rule 2 (Time Card Not Required), an individual is paid regardless of time keyed. Exception time (leave claimed) only is to be entered.
- When TM Status 9 (Planned Times) and Time Card Rule 1 (Time Card Required), an individual must enter exception time or certification that all planned hours were worked.

Discussions with Personnel found that for individuals who are salaried and are established as positive time, the pay rate is calculated on the total number of regular work and leave hours provided to KHRIS, not on the schedule hours for the individual. Therefore, if time is not sent up for a day, the individual will still receive their full salary pay, but the pay rate per hour will not be accurate. Therefore, the HRG training manual is incorrect. As this process affects pay rates, it could potentially affect cost allocation for regular time and distribution of costs for leave. Discussions with agency personnel revealed the pay period rate for Salaried/Positive Time employees is a work in progress with the KHRIS Time and Payroll Team. On May 20, 2012, a new system audit was implemented to enforce the positive time schedule, requiring all regular and leave time to add up to their daily schedule. As this enforcement of the schedules for these staff will, in effect, cause the pay rate to be based on their scheduled hours, this situation should no longer be a problem going into FY 2013.

Based on discussion with Auditor of Public Account (APA) county auditors, Personnel, and Finance Administration and Cabinet (FAC) staff, we learned Warren County inadvertently processed its payroll twice for the April 1-15, 2011 pay period. Subsequently, Warren County realized the error and requested a refund, which was processed through KHRIS in an off-cycle payroll. As part of this process in KHRIS, a refund transaction is submitted to eMARS for the net amount to be recovered. Warren County was unaware that the refund would be sent from KHRIS to eMARS; therefore, they presented the erroneous checks to Finance for redeposit into their account. These actions effectively caused the refund amount to be processed twice. After this situation was discovered by the auditors, a correction transaction was submitted to eMARS. Discussion with Personnel revealed procedures associated with reversals/refunds have been developed; however, it appears all parties involved in the process are not aware of the steps they are responsible for to process the transaction.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-45: The Personnel Cabinet Did Not Ensure Processing Associated With The Kentucky Human Resource Information System Functions As Intended (Continued)

On May 9, 2012, we learned that an APA employee, who contributes to the Kentucky Retirement System (KRS), had none of their wages reported to KRS for the month of February 2012. Discussion with Personnel revealed KRS had a backlog of suspended transactions to process, which they were working to reprocess by June 30, 2012. Personnel further stated, “The Personnel Cabinet and KRS are working together to define an ongoing process by which these suspended transactions can be identified promptly and worked more expediently.” As of the end of fieldwork, this process had not been defined.

If system processes and/or functionality is not well designed or implemented, the accuracy of processed information, operational efficiency and effectiveness, and compliance with relevant regulations, policies and procedures is compromised. State agencies are negatively impacted by the inadequate design of the system since they are burdened with performing extra tasks to determine if their data processed completely and accurately through KHRIS. Further, data processing problems may result in non-compliance with federal requirements.

Compliance requirements and significant operational processes and practices employed in administering the payroll and personnel functions for the State of Kentucky as they are established within the KHRIS system should be thoroughly documented or communicated to all appropriate agency personnel. Further, the Personnel Cabinet should ensure that all transactions entered into the KHRIS system are appropriate, are processed as expected, and are reported accurately.

Recommendation

We recommend the Personnel Cabinet take these steps to ensure complete and accurate data processing:

- Calculate employee pay rates consistently and uniformly within KHRIS to ensure that rates are reflective of the actual hours scheduled for the position.
- Validate positive time employee payroll information to ensure pay rates are calculated accurately.
- Ensure reversal/refund procedures are documented and communicated to all Personnel, FAC, and agency and county staff involved with this processing.
- Develop a process to ensure transactions suspended by KRS are properly identified, affected agencies are notified, and transactions are reprocessed in a timely manner.

Management’s Response and Corrective Action Plan:

The Personnel Cabinet appreciates the Auditor’s Office’s additional work to ensure accurate payroll processing for all employees as well as proper documentation and education of our HR user community.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-45: The Personnel Cabinet Did Not Ensure Processing Associated With The Kentucky Human Resource Information System Functions As Intended (Continued)**

Management's Response and Corrective Action Plan:

With the implementation of the new Overtime Allocation configuration, the Time Evaluation program will not allow time entry for positive time salaried employees whose hours do not equal the specified number of work hours for a work week (37.5 or 40). This ensures that payroll calculation for pay rate will be correct. This configuration was implemented as an informational message for time entered beginning May 20, 2012, and as a hard error in payroll for time entered beginning July 1, 2012.

Reversal/refund procedures in KHRIS are documented in Quick Reference Guides and published on the HR Administrator page on the Personnel Cabinet website. Communications have been sent to agency and county HR users to reinforce procedures.

The Personnel Cabinet and KRS have developed a process to improve the timing and communication related to transactions suspended by the KRS START system. This process was implemented in June of 2012 and allows for earlier identification of suspended transactions, notification to the agency and/or the Personnel Cabinet accordingly and reprocessing of suspended transactions in a more timely process.

Thank you for your continued efforts to ensure proper system controls, accurate payroll processing for all employees, proper documentation and communications are in place for systems supported by DTS.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-46: The Personnel Cabinet Did Not Implement Adequate Procedures To Ensure Changes Made To The Kentucky Human Resource Information System Were Appropriate

During our Fiscal Year (FY) 2012 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resource Information System (KHRIS), we determined formal change control procedures were developed and implemented on August 3, 2011, which is four months after the system went into production. Further, these procedures were not consistently applied to all changes made to KHRIS.

The System Change Request (SCR) Issue Quality Control (QC) flowchart and various functional narratives were developed to explain the change control process currently in place. To initiate a change, the Business Owner will complete the KHRIS Change Request (KCR) form, which provides details about the requested change. If the KCR is approved, then the KHRIS Functional Teams will complete the SCR Impact Assessment form. This form is used to document estimates of hours and costs to be expended toward developing and testing the change. Test results are documented by the Functional Teams on the Transport Test Status form. If the change passes testing, then the transport is released to production by the Integration Manager or member of the Basis Team.

Between August 3, 2011 and January 2, 2012, Personnel completed and submitted a Transport Request Form to show a transport object was tested and approved to be moved to production. However, this form stopped being used, and as of January 3, 2012, details related to the transport release were documented within a text file, which is attached to the actual transport object. Based on a comparison of these two files, it appears the new detail (text) file does not capture the employee's name who implemented the change to production or the date in which this transport was made.

In comparing the flowchart and narratives provided by Personnel describing the program modification procedures, discrepancies were identified in the reported processes and procedures, specifically in relation to the Quality Control (QC) environment. Further, these documents make reference to a KHRIS Oversight Committee (KOC), which was a subset of the KHRIS Governance Council, but no longer meets.

Meetings between the Project Manager and other technical teams are held on a regular basis to ensure all changes are moving through the process towards production implementation. However, discussion with management revealed meeting minutes are not maintained. In addition, the Business Owner, who request specific changes to KHRIS, are not always directly involved during these meetings.

Further, the Meeting Log, which contains a comprehensive listing of potential system changes, was not available for audit purposes. Also, even though the change control procedures indicate projects recorded on the Future Design Consideration (FDC) Log are assigned a priority, review of the log revealed that a data field to capture the priority has not been included. Therefore, there is no way to know which changes may be considered for development.

To determine adherence to established procedures, the auditor tested 28 out of 194 SCRs, or 14.4 percent. For each sampled change, the auditor requested supporting documentation including a completed KCR form, SCR Impact Assessment form, the Transport Test Status form, and the Transport Request form or detail object file. Testing associated with the KHRIS change management process revealed the following exceptions:

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-46: The Personnel Cabinet Did Not Implement Adequate Procedures To Ensure Changes Made To The Kentucky Human Resource Information System Were Appropriate (Continued)

- For one of the 28 sampled changes, 3.6 percent, a properly completed SCR Impact Assessment form was on file; however, the form did not accurately reflect all associated SCR numbers.
- For 10 of the 28 sampled changes, or 35.7 percent, a properly completed Transport Test Status form was not on file and no additional support was provided for four of these changes. For six other changes, screen prints or other supporting documentation was provided; however, this documentation does not show the results of testing (pass/fail). Also, one of these changes appeared to have been implemented to production prior to testing being completed.
- For 17 of the 28 sampled changes, or 60.7 percent, a Transport Request Form or Detail Object was not on file and no additional support was provided for one of these changes. For the remaining 16 changes, screen prints or print outs of the transport log were provided; however, this does not reflect dates in which the changes were moved to production and by whom.
- For five of the 28 sampled changes, or 17.9 percent, a Transport Request form was on file; however, the form was not properly completed to show who implemented the change to production and when.
- Five of the 28 changes, or 17.9 percent, did not have one or more of the tested forms (SCR Impact Assessment form, Transport Test Status form, and/or Transport Request Form/Detail Object) on file; however, this was due to the fact that the changes were either still in progress or determined to no longer be required. However, the SCR Log wasn't properly updated to reflect this change in status.

Failure to properly apply and monitor change control procedures increases the risk that incorrect or unauthorized changes could be made to critical applications and, potentially, be moved into the live production environment.

Program modification control procedures have been established for the KHRIS system. These procedures should be consistently applied to ensure only appropriately authorized changes to critical applications are made and implemented within the production environment. Consistent monitoring of the change control process should ensure adequate documentation exists for all changes and that the changes made are acceptable to the user business areas prior to implementation.

Recommendation

We recommend Personnel review established procedures to identify potential anomalies and ensure these are updated to accurately reflect processes and procedures currently in place. The KCR Form, SCR Impact Assessment Form, and Transport Test Status Form should be properly completed and approved by the appropriate staff. Further, consideration should be given to reinstating the Transport Request Form. If Personnel chooses to continue to use the transport detail object, this file should be updated timely to ensure it captures the name of the individual responsible for promoting a change to production as well as the date in which this occurred. Also, any error codes that resulted from the transport to production and actions taken to resolve the error should be noted on the file as well.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-46: The Personnel Cabinet Did Not Implement Adequate Procedures To Ensure Changes Made To The Kentucky Human Resource Information System Were Appropriate (Continued)

Recommendation (Continued)

We recommend Personnel begin retaining the review meeting log and creating detailed minutes of any meetings held to discuss changes currently in progress. Also, Business Owners should be encouraged to attend meetings in which additional information may be required before development of a change begins.

We also recommend Personnel update the SCR Log to ensure it accurately reflects the status of each change in progress. This will allow for ease of review to ensure each change is properly requested, tested and promoted to production. Further, we recommend Personnel expand the FDC Log to include the priority of these future changes to ensure that the reviewers are able to identify which changes may be considered for development.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates the Auditor's Office's comments and recommendations in regard to the Division of Technology Services' (DTS) Change Control Process and agrees with the criticality of this system control and is committed to ensuring it works best for DTS and KHRIS Business Owners to ensure the change process is sound to prohibit unintended change in the system as well as proper authorization and knowledge of changes made in systems.

DTS will be reviewing these procedures and revise as needed to ensure the integrity of the process and that the documentation of the process is current.

The Transport Request Form was determined to be a superfluous artifact of the change process and will not be reinstated; however, DTS will ensure sufficient information is included in all other documentation a part of this process going forward to include documentation on transports that import to a system in error. These will require an additional transport as a corrective action which will also include detail in documentation to its purpose.

The Future Design Consideration (FDC) Tracking Sheet and the SCR Request Log are no longer maintained by DTS as FDC tracking was returned to the business areas in early 2012. When a business area requires an item from their FDCs, it is submitted to the KHRIS Service Center through a KHRIS Change Request (KCR) per the DTS Change Control Process and logged in DTS's incident tracking system. Review meetings are held as a part of this process and Business Owners are in attendance including the Office of Administrative Services. If approved, the KCR is then available for prioritization by the business area during scheduled prioritization meetings. Once determined by the business as high in priority, DTS staff creates a System Change Request (SCR) for level of effort and scope which is reviewed by DTS leadership. Approved SCRs are then tracked and the change is ultimately moved to production per the DTS Change Control Process.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

FINDING 12-PC-46: The Personnel Cabinet Did Not Implement Adequate Procedures To Ensure Changes Made To The Kentucky Human Resource Information System Were Appropriate (Continued)

Management's Response and Corrective Action Plan (Continued)

The DTS Project Management Office tracks approved KCRs and SCRs, statuses, and recaps of prioritization meetings through an Operational Status Update report that is distributed to all KHRIS Business Owners. This should meet the recommendation made for meeting logs and minutes of this process.

Thank you for your continued efforts to ensure proper system controls are in place such as DTS's critical Change Control Process for systems supported by DTS.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-47: The Personnel Cabinet Did Not Ensure Appropriate Reporting Was Available, Complete, and Accurate Within The Kentucky Human Resource Information System**

Based on our Fiscal Year (FY) 2012 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resource Information System (KHRIS), we identified several concerns related to the functionality, availability, and completeness of reporting within KHRIS. Many of these issues were originally commented on during our prior year audit.

KHRIS went into production on April 1, 2011. At that time, Personnel had not developed numerous reports within KHRIS that were comparable to what was previously available within the legacy system. Legacy reports used to reconcile time and payroll data not available in KHRIS when first implemented included reports 151 - Carrier and Deductions, 152 and 152A - Payroll Registers, and 153 - Payroll Distributions. The Payroll Distribution Report (PDR) became available on July 18, 2011 and replaced the 153 - Payroll Distributions legacy report. The PDR contains the following fields: Check Date; Cost Center; Organizational Unit and Name; Employee Name; Accounting Template; Work Breakdown Structure (WBS) Unit, Location and Activity; Work Order, Object, Hours Worked, Earnings by Object Code, and Total Employer Costs. Our audit revealed state agencies as well as county officials still have problems reconciling their payroll data to the enhanced Management Administrative and Reporting System (eMARS) based on the current KHRIS reports available.

Discussion with county officials revealed they were not able to generate their own PDRs until July 2012. Until then, in order to reconcile their payroll data, Personnel sent the PDRs to the Finance and Administration Cabinet (FAC) County Fee Systems, who then distributed the reports to the appropriate personnel; however, there was no constant format of the spreadsheet, making the process more difficult. Furthermore, it has been determined that totals reported on the Payroll Journal and PDR typically do not agree. As a result, counties are unable to properly reconcile their payroll entries in KHRIS to eMARS. The KHRIS team is aware of this issue and have stated that the discrepancies are due to the allocation of wage types on each report. The PDR has been determined to accurately reflect the information within eMARS; however the Payroll Journal does not. We are aware that Personnel plans on correcting the Payroll Journal.

As of the end of field work, the Transportation Enterprise Database (TED) interface was not created. The TED interface was anticipated to provide Kentucky Transportation Cabinet (KYTC) staff with detailed labor data relating to each pay period. This detail is necessary for federal reporting purposes. KYTC was under the impression the TED interface would be developed after the statewide data feeds to infoAdvantage had been completed, which occurred in October 2011. However, Personnel indicated this interface would not be developed since they were able to meet the business need in a more efficient manner by loading associated payroll data to infoAdvantage. In addition, Personnel stated they are currently reviewing system requirements to add time data to infoAdvantage. However, this change in project scope was never communicated to the business unit. In order to provide detailed personnel cost data required for Federal Emergency Management Agency (FEMA) and American Recovery and Reinvestment Act (ARRA) reports, KYTC staff must complete two different timesheets, which is overly burdensome and takes away from staff performing daily job tasks. KYTC staff are also working to develop additional reports outside of KHRIS. Even though Personnel believes they are meeting the business need in a more efficient manner, they did not take into consideration the additional work KYTC is having to perform to ensure they are compliant with federal regulations.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-47: The Personnel Cabinet Did Not Ensure Appropriate Reporting Was Available, Complete, And Accurate Within The Kentucky Human Resource Information System (Continued)

Furthermore, a report of the tax breakout associated with Off-Cycle payrolls is not automatically created by KHRIS and provided to the Kentucky State Treasury (Treasury). While a report is provided, Personnel Cabinet staff has to query the system in order to manually generate this report each pay period and then provide it to Treasury. Personnel indicated third party posting information could be determined via the Display Posting Runs (PCP0) transaction code. However, Treasury confirmed this transaction code is not used and the auditor could not determine how the reported information was useful to the reporting of third party taxes.

Finally, it was noted that the compensatory leave hours earned for the days of a partial week that fall in the previous pay period are not reflected in the “Earned” field of the pay stub. A partial week is defined as a work week (Sunday – Saturday) that spans two pay periods. Since KHRIS cannot calculate compensatory time earned for these days until the full week has been completed, those additional hours worked in a partial week at the end of a period are held in a “bucket” within KHRIS until the next pay period time has been coded to determine how to deal with the additional time. Once the next pay period information is entered, KHRIS will calculate the compensatory time for the “bucket” hours along with the current period. However, it appears that the pay stub is not capturing these partial week hours within the Earned data field. The ending compensatory leave balance is being correctly calculated and provided on the employee’s pay stub.

Without adequate reporting, the risk increases for a user to develop reports based on incorrect data elements. Further, state agencies may be unable to properly reconcile payroll costs processed through the system. Federal funding may also be compromised without complete and timely reporting.

Good internal controls dictate procedures be in place to ensure all reports used for financial reporting are complete and accurate. For reports to be useful and valid for management decision-making purposes, the reporting solution used should be appropriately designed to allow users to view data and develop reports that are complete and accurate. A reporting solution must, therefore, be understandable by the end user in structure, content, and context. Further, the underlying structure of the data must be appropriate for the overall accounting regulations of the organization; otherwise, the solution may provide information that is not expected by the end user.

Recommendation

We recommend the Personnel Cabinet take the following actions in relation to the reporting functionality within the new KHRIS application:

- Reach out to various business units to determine what reporting functionality is missing from KHRIS and needed to perform daily job tasks and bi-monthly reconciliations. Documentation should be maintained to show what functionality is required and being considered for future development. Further, proper oversight and management of this project should be applied to ensure all parties agree on the configuration needed.
- The KHRIS team should consider developing additional reports containing information needed by all federal agencies.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-47: The Personnel Cabinet Did Not Ensure Appropriate Reporting Was Available, Complete, And Accurate Within The Kentucky Human Resource Information System (Continued)

Recommendation (Continued)

- Create a report that will be automatically generated within KHRIS to reflect taxes associated with off-cycle payroll. Treasury should be given the ability to generate this report every pay period. If the intent of the PCP0 transaction code was to provide such information to Treasury, then adequate documentation should be developed and provided to Treasury explaining how to use this transaction code and associated results.
- Ensure the reporting of the earned compensatory time on the pay stub reflects all leave earned for the period including any time earned during a partial week from a prior period.
- Continue its work to ensure the totals reported on the Payroll Journal agree to what is reported on the PDR. Once a fix has been developed, adequate testing should be performed prior to making the necessary changes within KHRIS. HRGs should be informed when the Payroll Journal is fixed so they can use this for reconciliation purposes.
- Develop training for HRGs and other appropriate agency staff related to the use of KHRIS reports to reconcile their payroll information to the postings within eMARS.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates the Auditor's Office's comments and recommendations in regard to reporting in KHRIS to ensure adequacy, completeness and accuracy. The Division of Employee Management (DEM) did complete a survey on KHRIS reporting with agencies in March of 2012. DEM will submit requests for any additional reports they deem as necessary to meet any reconciliation or federal reporting needs through the DTS Change Control Process. These requests will be scoped and prioritized by the business area for implementation.

At DEM's request, via the DTS Change Control Process, DTS could develop a report for Treasury to execute; however, they will need to be provided with a third party posting key by DTS for each payroll and off cycle run. This key is a system generated number with a one to one relationship with payroll postings.

The interface of timesheet data (previously TEDS reporting requirements) has begun. This effort will produce an interface of detailed time reporting data available in KHRIS per the business requirements identified by the Office of State Budget Director (OSBD) with participation and alignment from the KY Transportation Cabinet. The interfaced data will be made available to all agencies via InfoAdvantage. The Time Management team has discussed reporting of retro compensatory time (from split week in prior pay periods). The Payroll team is investigating ways to reflect these retro hours onto the pay stub/remuneration statement. Time Management cannot "move" these earned hours into the current pay period. It has also been suggested, if payroll cannot move the comp earned in prior periods to the current for reporting on the pay stub, that the 6ADL hours held in the split week (wage type 2094) could be reported on the remuneration statement.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

FINDING 12-PC-47: The Personnel Cabinet Did Not Ensure Appropriate Reporting Was Available, Complete, And Accurate Within The Kentucky Human Resource Information System (Continued)

Management's Response and Corrective Action Plan (Continued)

DTS will continue to work on items such as the Payroll Journal as prioritized by the business per the DTS Change Control Process.

The KHRIS training team and DEM are now delivering an advanced payroll training course that will assist payroll officers with understanding additional functions in KHRIS including reporting and reconciliation. DTS and DEM have also been in preliminary discussions with OSBD to develop additional training for the FICO reporting role in KHRIS.

Thank you for your continued efforts to ensure the adequacy, completeness and accuracy of reporting in KHRIS.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-48: The Personnel Cabinet Did Not Ensure Regular And Off Cycle Payrolls Processed By The Kentucky Human Resource Information System Reconciled To The Enhanced Management Administrative And Reporting System

Based on our Fiscal Year (FY) 2012 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resource Information System (KHRIS), we determined Personnel had not adequately reconciled all payrolls processed in KHRIS to what was recorded within the enhanced Management Administrative and Reporting System (eMARS). Further, adequate documentation was not maintained to support the totals processed by KHRIS for pay period 13 (July 1-15, 2011 payroll).

During the FY 2011 audit, we determined Personnel had not developed written reconciliation procedures or reconciled KHRIS's payroll entries to eMARS since April 2011 when KHRIS went into production. For FY 2012, Personnel developed documentation explaining pre-audit processing procedures as well as the creation of Extensible Markup Language (XML) file names, amounts and total counts that were to be submitted to eMARS. File names, amounts, and total counts are recorded on Payroll Run Sheets each pay period. XML files are to be loaded to eMARS and contain the individual documents created during payroll processing, which consist of Cost Allocation (CA) totals and deductions, Third Party Payments (3PR), Check Writer Accounting (CWA) documents, and Payment Request - Commodity Based (PRC) documents. Each of these documents are associated with the Payroll Clearing Fund - 13XX or the Payroll Clearing Fund for Third Party Payments - 14XX. Personnel is responsible for the completeness and accuracy of the data within the XML files. The Finance and Administration Cabinet (Finance) is responsible for ensuring the syntax of XML files is correct and that the files mathematically balance. Finance also loads the files to eMARS. Finance has developed Standard Operating Procedures (SOP) to ensure these files are complete and loaded to eMARS in a timely fashion.

For FY 2012, we reviewed the reconciliation of regular payrolls for all 21 pay periods processed by KHRIS since April 1, 2011 through February 2012 (February 1-15, 2012 payroll). During this review we found a Payroll Run Sheet was not on file to support the regular and off cycle payrolls processed for pay period 13. According to eMARS, the CA deductions total \$52,273,887, the CWA totals \$42,521,801, the PRC totals \$232,075, and the 3PR CA totals \$361,126 for pay period 13; however, we cannot confirm these are the actual amounts processed by KHRIS. Discussion with agency personnel revealed these totals could not be determined since there were significant processing issues during this pay period which resulted in an unusually large number of files being processed and sent to eMARS. Documentation was on file to show the XML file names generated, but only the regular CA totals processed for pay period 13 were identified.

Further, PRCs for pay periods 7-10 and 15 as processed in KHRIS did not reconcile to the amounts reported in eMARS. The following discrepancies were noted:

- Pay period 7 – \$21,426 [Regular Payroll]
- Pay period 8 – \$167,688 [Regular Payroll]
- Pay period 9 – \$138,498 [Regular Payroll]
- Pay period 10 – \$158 [Regular Payroll]
- Pay period 15 – \$57,512 [Regular Payroll]; \$2,876 [Off Cycle Payroll]

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-48: The Personnel Cabinet Did Not Ensure Regular And Off Cycle Payrolls Processed By The Kentucky Human Resource Information System Reconciled To The Enhanced Management Administrative And Reporting System (Continued)**

Personnel did not maintain documentation to explain why these discrepancies occurred or how they were to be resolved. Finance was able to provide additional documentation to show which documents and/or Personnel Numbers (PerNrs) were associated with these variances.

One of the 21 pay periods processed in KHRIS was further reviewed to ensure off cycles generated were properly accounted for and reconciled to eMARS. For one of three off cycles processed in KHRIS for pay period 20 (October 16-31, 2011 payroll), the Third Party payment in the amount of \$641.31 was appropriately processed on a CWA document; however, there was not a corresponding CA document to properly allocate the funds to the various agencies. Personnel had a payroll run sheet on file for this off cycle which contained the associated XML file name generated; however, discussions with Finance staff revealed Personnel had not loaded the Third Party CA file, which KHRIS generated on October 31 2011. Finance loaded this file to eMARS on September 4, 2012. Subsequently, the Personnel Cabinet's Division of Technology Services (DTS) reviewed all XML files generated for FY 2013 and confirmed they were all loaded to eMARS.

Without consistently following reconciliation procedures in place, the Personnel Cabinet cannot ensure proper reconciliation of the state's payroll data processed through KHRIS. Personnel should be aware of all discrepancies resulting from payrolls processed in KHRIS to ensure timely reconciliations. Payroll funds are not properly distributed to state agencies if CA documents are not generated by KHRIS and processed in eMARS, which will cause reconciliation problems for agencies.

The Personnel Cabinet should ensure all payroll transactions produced by the KHRIS system are captured and appropriately reported to the eMARS system for processing. Reconciliation of the statewide payroll data should be performed in a timely manner. Personnel should not rely solely on Finance to validate all payroll data processed by KHRIS. Reconciliation of the KHRIS data should be validated by Personnel in conjunction with Finance as one payroll was not properly accounted for resulting in questions of the actual payroll amount recorded.

Recommendation

We recommend the Personnel Cabinet work with Finance to ensure all discrepancies identified during the reconciliation process are resolved in a timely manner. The current reconciliation procedures should be expanded to address how both agencies will deal with variances identified between KHRIS and eMARS. Personnel should provide assistance to Finance to resolve the discrepancies noted with pay periods 7-10 and 15.

In addition, we recommend Personnel review all XML files generated by KHRIS between April 2011 and June 2012 to ensure they were appropriately loaded to eMARS. For any files found to have not been loaded during this time frame, a request should be made to Finance to load and validate the files accordingly.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-48: The Personnel Cabinet Did Not Ensure Regular And Off Cycle Payrolls Processed By The Kentucky Human Resource Information System Reconciled To The Enhanced Management Administrative And Reporting System (Continued)**

Recommendation (Continued)

Further, we recommend Personnel maintain adequate documentation to support all regular and off cycle payrolls processed by KHRIS. Payroll Run Sheets should be stored in a centralized location and made available for audit purposes.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates the Auditor's Office's comments and recommendations in regard to ensuring all KHRIS payroll transactions are captured and appropriately reported in eMARS. The Division of Technology Services (DTS) works with the eMARS team on any discrepancies that arise with KHRIS payroll files/infoAdvantage files. The eMARS team currently compares the infoAdvantage files and the CA documents. If they do not balance, the DTS/KHRIS FICO Team assists in the reconciliation. DTS works with Finance on any discrepancies identified related to the payroll posting and reporting processes.

DTS is now recording in a spreadsheet the load of each XML payroll file to eMARS and reconciling to ensure all payroll files produced in KHRIS are captured in eMARS. This process began in Pay Period 12 and will continue going forward. DTS is currently reviewing all XML files generated by KHRIS between April 2011 and June 2012 to ensure they were appropriately loaded to eMARS. This documentation is being stored in a central location.

Thank you for your continued efforts to ensure all KHRIS payroll transactions are captured and appropriately reported in eMARS.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-49: The Personnel Cabinet Did Not Maintain Adequate Documentation Associated With Leave Accruals Processed By The Kentucky Human Resource Information System

During our Fiscal Year (FY) 2012 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resource Information System (KHRIS), we determined that while Personnel developed system documentation explaining how time data and accruals of leave time are calculated and processed by the system, the documentation is not complete in relation to the processing of compensatory leave accruals and usage, accruals of annual and sick leave for certain employee groups, and limitation on compensatory leave quota and Block 50 processing.

Starting with the May 16-31, 2011 pay period, compensatory leave within KHRIS is calculated based on a split week. Additional hours worked in a split week are not added to the employee's compensatory leave quota until after the end of the week, which falls in the next pay period. Any hours worked in the first part of the split week are essentially held in a "bucket" within KHRIS until the next pay period when the end of the split week is processed. Even though these hours are maintained separately, administratively compensatory leave hours earned during the split week are available to employees for use during the period in which they were earned. As a result, KHRIS will allow a certain threshold of negative compensatory leave hours and will not give a hard stop error.

During the FY 2011 audit, we recommended Personnel configure KHRIS to raise a warning flag at the point of time entry to identify employees with negative compensatory leave quota balances. Personnel indicated this is not feasible since compensatory time is calculated on a work week and timesheet edits are based on pay period. While employees cannot see the held hours in a "bucket", the HRG can see these hours using certain transactions and variants within KHRIS. Personnel holds agency staff responsible for monitoring these instances and for not approving compensatory leave to be used when it has not been earned by the employee. However, since the negative balance is not tied to the split week additional hour "bucket", the Personnel Cabinet runs the risk of paying individuals for hours not previously available or earned within the period.

Leave accrual data was provided by the Personnel Cabinet, which reflected annual, sick, and compensatory leave balances for all state employees as of March 31, 2011 through March 15, 2012. While this information is viewable within KHRIS via transaction code PT_BAL00, due to the large amount of data involved, the Personnel Cabinet had to generate these reports for the auditors in order for testing to be performed.

Testing of accruals was performed for FY 2012 to ensure state employees did not receive more annual, sick, or compensatory leave than allowed based on 101 KAR 2:102, Classified Leave Administration Regulations and 101 KAR 3:015, Leave Administrative Regulations For The Unclassified Service. This testing revealed a total of 85 employees with an Employee Group of 'E,' which represents Kentucky Revised Statute (KRS) Chapter 161 (Department of Education) employees, earned 22.5 hours of annual leave and 75 hours of sick leave on July 15, 2011. The auditor determined the hours earned were correct. However, based on documented processing procedures, the annual hours should have been granted on the first day of the calendar year, or January 2011. Discussion with agency personnel revealed these hours are to be granted at the beginning of each school year. Further, the procedures developed do not discuss or explain how to account for sick leave accruals associated with Chapter 161 employees.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-PC-49: The Personnel Cabinet Did Not Maintain Adequate Documentation Associated With Leave Accruals Processed By The Kentucky Human Resource Information System (Continued)

Further, 12 of 47 sampled employees, or 25.5 percent, accumulated compensatory leave in excess of 240 hours without being paid any Block 50s. A Block 50 is defined as a payment or a movement to the individual's sick leave quota of 50 hours of time when an individual reaches 240 hours in their compensatory leave quota. Discussion with the agency revealed one of these employees works for the Legislative Research Commission (LRC) and can maintain any number of compensatory leave hours, but will only be paid for 240 hours at retirement. The other 11 employees have been classified as Employee Group 'R,' which represents KRS Chapter 16 (Department of Kentucky State Police) employees. These employees were established with a Block 50 status of "3-No Limit-No Block 50 Processing." Therefore, these individuals can earn compensatory leave hours with no limit. Though the processing of compensatory leave time was handled correctly in these 12 instances, the documented procedures do not discuss such exceptions to the normal processing of Block 50s.

Without complete and accurate documentation regarding the processing of leave accruals, the agency can inadvertently calculate an employee's leave earned or used incorrectly and may not properly compensate the employee. By allowing employees to have a negative compensatory leave quota, the Personnel Cabinet can essentially pay an employee for hours or leave to which they are not entitled.

The capture of employee time allocations and leave is essential to the accurate processing of payroll and related financial reporting. Payroll processing will only be accurate if employee time and leave requests have been captured correctly by the system. Annual, sick, and compensatory leave accumulation rates and limits are governed by 101 KAR 2:102 and 101 KAR 3:015. Employees should be accurately compensated and not be paid for hours not earned.

Recommendation

We recommend the Personnel Cabinet expand their leave accrual processing documentation to explain how Human Resource Generalists (HRGs) should monitor and maintain employee's compensatory leave balances to ensure they are not paid for time not worked. This documentation should be distributed to all HRGs to ensure they are aware of processing associated with the split week and their responsibility to ensure employees are not paid for time not worked.

Since a 'warning flag' is not feasible within KHRIS, we recommend the Personnel Cabinet perform periodic reviews of all employee compensatory balances to ensure that the process of allowing this balance to go into a negative situation is not being abused. This process should ensure appropriate actions are being taken by agency personnel to validate negative compensatory balances.

In addition, we recommend the Personnel Cabinet develop a report within KHRIS similar to legacy which will show leave quota balances, accruals, and usage over a requested time period. This report should be able to be queried for a range of dates and criteria including by an individual employee, a group of employees, or organization unit.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-PC-49: The Personnel Cabinet Did Not Maintain Adequate Documentation Associated With Leave Accruals Processed By The Kentucky Human Resource Information System (Continued)**

Recommendation (Continued)

Further, we recommend Personnel review and make necessary revisions to the system documentation related to accruals and Block 50 processing for specific situations that are not currently addressed.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates the Auditor's Office's additional work to ensure compliance monitoring of employee leave balances. The KHRIS team will work with the Division of Employee Management (DEM) to provide additional input on training and educational materials to assist HRGs with time monitoring.

The DTS/KHRIS Time Management team could provide updated leave accrual documentation to include Block 50 as well as more detail about how Comp balances are maintained and adjusted at the request and prioritization of DEM. Current reports via transaction PT_BAL00 show balances, accruals and usage over periods of time. Also, the KHRIS training team can work with DEM to ensure a larger point of emphasis on leave balance monitoring in Time Reporting training.

Thank you for your continued efforts to ensure compliance monitoring of employee leave balances in KHRIS.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-TC-50: The Kentucky Transportation Cabinet Did Not Ensure Segregation Of Duties Among Personnel Performing Year End Inventory Counts

During the FY12 audit, we observed KYTC personnel counting inventory in the maintenance garages in 13 counties. In several counties, we noted personnel did not follow inventory procedures as outlined in KYTC's Operations Management System (OMS) Materials Inventory User Guide.

Specifically, we noted:

1. The timekeeper counted and recorded the inventory in two counties. Timekeepers order and receive inventory and should not also count and record the inventory.
(Lewis in District Nine and Fayette in District Seven)
2. Only one person (the timekeeper) counted and recorded the inventory in two counties. There should be two inventory takers.
(Lewis in District Nine and Fayette in District Seven)

KYTC does not have effective segregation of duties. Allowing one person to order, receive, and count the inventory, could result in errors or thefts going undetected. The inventory may not be accurate because the procedure manual was not followed.

MAT sections 601 of the Material Policy and Procedure manual states:

- The person responsible for ordering and issuing inventory should not be counting the inventory. This means that timekeepers should only help with locating material, but should not be in charge of counting or recording of inventory items.
- Counts shall be performed in teams of at least two people. One person is responsible for the count, and the other is responsible for recording.

Recommendation

We recommend central office personnel implement procedures to ensure segregation of duties between the individuals receiving items, recording items in OMS, and performing the final year-end inventory count.

Management's Response and Corrective Action Plan

Personnel in the maintenance facilities that perform inventory are not responsible for ordering or receiving orders, that is left to the section offices, for the very reasons cited. In performing inventory, our personnel have been trained to have one person counting and one person writing. District 9 will investigate and insure procedures are followed and hold the individuals in Lewis County accountable.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-TC-50: The Kentucky Transportation Cabinet Did Not Ensure Segregation Of Duties Among Personnel Performing Year End Inventory Counts**

Management's Response and Corrective Action Plan (Continued)

District Seven agrees with the recommendation of the audit. District Seven will correct inventory procedures for the Fayette County Maintenance Facility. The timekeeper will be replaced with a two member team to count and record inventory. This correction will be implemented during the next inventory. PD&P Branch I Branch Manager, will be responsible for corrective action.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-TC-51: The Kentucky Transportation Cabinet Did Not Detect And Correct A Large Data Entry Error

During the FY2012 audit of KYTC inventory, we analyzed inventory by district, using data from the Operations Management System (OMS). OMS tracks inventory for KYTC. We noted one unusual item in District Six during the analysis. Upon inquiry, we learned an OMS operator accidentally entered the square feet of rolls of fabric instead of the number of rolls received. The amount in District Six in FY11 was \$4,166,182 and in FY12 \$13,158,711 (before the error was noticed). As a result of the error, a decrease to the overall inventory balance from \$66,549,895 to \$57,320,034 on the closing package form was required (a \$9,229,861 decrease).

The problem was caused by data entry error. The amount of inventory initially reported on the Inventory closing package was overstated by \$9,229,861. If the error had not been discovered, the inventory on the financial statements would have been overstated and incorrect.

Good internal controls should ensure the quantity of materials entered is reasonable and accurate. This ensures the financial statements and OMS tracking system report accurate and reliable information to users.

Recommendation

We recommend KYTC:

- Re-evaluate the maximum values set in OMS for reasonableness.
- Consider reviewing inventory amounts at various times throughout the year to determine if the amount of each item appears reasonable.

Management's Response and Corrective Action Plan

District Six Response

We will review inventory amounts at various times throughout the year to determine if the amount of each item appears reasonable. We will also have different staff members perform periodic reviews of data for accuracy.

Division of Maintenance Response

The issue of maximum/minimum cost values relates to the unit cost of an item. In this instance, the maximum allowable unit cost was not exceeded. Rather, due to misinterpretation of the unit the user entered in an excessive quantity for the subject item. Whereas it is relatively simple to establish minimum and maximum unit costs for individual material items, establishing maximum on-hand quantities for individual items is difficult due to the varying need within separate crews.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-TC-51: The Kentucky Transportation Cabinet Did Not Detect And Correct A Large Data Entry Error (Continued)**

Management's Response and Corrective Action Plan (Continued)***Division of Maintenance Response (Continued)***

It may be possible to address this issue but careful consideration must be given in order to avoid major disruptions. KYTC Division of Maintenance will review this further and will develop a process to address. Unless software development or other issues necessitate a later implementation, the solution will be implemented by the end of 2012.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-TC-52: The Kentucky Transportation Cabinet Did Not Ensure Employees And Supervisors Signed Timesheets, Obtained Pre-Approved Of Overtime, And Coded Time To The Correct Project Codes

Kentucky Transportation Cabinet (KYTC) employees record time worked on a Daily Attendance and Project Report. When applicable, employees also record time on a excel spreadsheet daily. The timesheet is signed by the employee as well as verified and signed by their immediate supervisor. Also, overtime is normally approved in advance. Timesheet information is entered into the Kentucky Human Resources Information Systems (KHRIS). The timesheets document the hours worked by project charge codes, which ensure payroll is recorded in the proper accounts.

During our audit of KYTC, we reviewed 60 timesheets, and noted the following:

- One timesheet was not signed by the supervisor.
- In two instances there was no documentation of overtime pre-approval.
- In three instances, the project code on the timesheet did not match the project code recorded in KHRIS.

While reviewing the 60 timesheets we noted the following additional errors for employees not included in our sample, but listed on the supporting documentation:

- Five employees did not sign their timesheets. Additionally, in one instance an employee signed only her first name.
- A supervisor signed a blanket overtime approval for employees, including himself. The supervisor's superior should have signed the overtime request.

Employees document the accuracy of time worked by signing their timesheet. By not signing the timesheet, the employee did not verify the time worked and supervisors cannot rely on the accuracy of the timesheet. Supervisors document their review by signing each employee's timesheet. By not signing the timesheet, there is no evidence to ensure the timesheet was reviewed by authorized personnel.

When incorrect program codes are entered in KHRIS, a program could be charged for work not performed for that program. This could result in inaccurate KHRIS reports and federal programs being charged incorrectly.

If overtime is worked without advance approval, KYTC would be responsible for compensating the employee even if overtime was not necessary. An employee could work overtime unnecessarily if the employee is allowed to approve their own overtime.

The General Administration and Personnel Manual Section GAP-501 states:

- Each day, employees shall report their times of arrival and departure, including lunch times, on the TC 12-261 form, *Daily Attendance and Project Report*, and sign the form certifying their reported time is accurate.
- Supervisors shall also sign the form certifying that all information reported by their employees is accurate and shall ensure that all *Applications for Leave, Applications for Compensatory Time/Overtime*, 261 form.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-TC-52: The Kentucky Transportation Cabinet Did Not Ensure Employees And Supervisors Signed Timesheets, Obtained Pre-Approved Of Overtime, And Coded Time To The Correct Project Codes (Continued)**

Good internal controls dictate that the correct projects should be charged for work performed and overtime is properly approved.

Recommendation

We recommend KYTC:

- Require timesheets be signed by the employee and supervisor to ensure correct data is reported.
- Require employees and managers to verify overtime through the pre-approved paperwork or an attached email.
- Reiterate to timekeepers to check not only the time but project codes as well after information has been entered into KHRIS. Timekeepers should also note which errors were adjusted when information was entered into the system on the timesheet.

Management's Response and Corrective Action Plan

We agree with the findings and recommendations. KYTC employees sign in and out daily using the Daily Attendance and Project Report (Form 12-261). In accordance with GAP policy, these are signed by employees and supervisors. At the end of each pay period, those sheets are entered into a KHRIS Excel timesheet and each employee signs and the supervisor compares the daily sheets to the KHRIS Excel timesheet to verify accuracy and signs. These KHRIS Excel sheets are converted into KHRIS by Time and Attendance Administrators and Contacts.

KYTC Secretary sent a memo and GAP 501-Leave Request and Time Reporting to all KYTC management personnel recently reminding them of time and attendance reporting and required documentation. We will continue to strive for improvement in this area.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-TC-53: The Kentucky Transportation Cabinet Did Not Report All Contingent Liabilities Paid**

KYTC's closing package forms AFR-70A *Summary of Contingent Liabilities and Judgments* and AFR-70B *Detail of Contingent Liabilities and Judgments Paid* are prepared by the Division of Accounts (DOA) based on information provided by the Office of Legal Services (OLS). During our review of the forms, we noted three closed cases for which a total of \$106,000 had been paid, but not reported on the AFR 70 forms. Upon further inquiry, we were informed OLS reported only amounts paid by OLS, not amounts paid by other departments in KYTC. The AFR 70 forms should include all contingent liabilities incurred in prior years and paid during the current year for the entire cabinet, regardless of the funding agency.

The AFR 70 forms did not include contingent liability payments for all departments within the cabinet. This resulted in the amount paid during the year being understated by \$106,000 on the AFR 70 forms.

The instructions for completing the AFR 70 forms state, "Any payments made for either judgments or contingencies should be shown on form AFR 70B." The instructions for line 10 of the AFR 70A form state, "Enter all amounts paid during the year. This includes payments for contingent liabilities/judgments recorded at June 30, 2011 (part of beginning balance) and for contingent liabilities/judgments incurred during the year (FY 2012). The total paid amounts should match the total of all paid amounts shown on AFR 70B."

Recommendation

KYTC plans to resolve the issue going forward rather than re-submitting corrected AFR 70 forms for FY12. We recommend OLS and DOA refine the procedures for completing the AFR 70 forms in subsequent years to ensure all information for the entire cabinet is accurately reported.

Management's Response and Corrective Action Plan

OLS and DOA have met and discussed this issue. Both offices are working towards the best solution to ensure all payments made as a result of a judgment or agreed order is captured annually. DOA will continue to complete the AFR70 forms with the best information available from the various KYTC offices.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-TC-54: The Kentucky Transportation Cabinet In Coordination With The Commonwealth Office Of Technology Did Not Ensure Sufficient Authentication Was Required To Access Potentially Sensitive Information

While performing the fiscal year (FY) 2012 security vulnerability assessment of machines owned and/or managed by the Kentucky Transportation Cabinet (KYTC) and the Commonwealth Office of Technology (COT), we discovered instances where no authentication was required to allow an outside user to gain access either to information about the machine or to the service running on a designated port. We determined 22 out of the 141 machines scanned, or approximately 15.6 percent of the population, did not have sufficient authentication enabled on one or more ports. Two of these machines are managed by KYTC, while the remaining 20 machines are managed by COT. One KYTC-managed machine and 14 COT-managed machines allowed file uploading through an anonymous access. In addition, nine COT-managed machines reported the administrative password was not set on one or more ports. Further, default credentials allowed anonymous access to two KYTC-managed machines and one COT-managed machine. One KYTC-managed machine and two COT-managed machines were reported on during the FY 2011 audit.

During fieldwork, we provided a listing of the nine COT-managed machines noted with administrative passwords not appropriately set to KYTC and COT. We would like to acknowledge that COT secured these machines prior to the end of fieldwork.

For security purposes, detailed information that would identify the specific machines contributing to these findings are being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

If a machine is allowed to provide excessive information associated with the machine to an anonymous user, then an intruder could potentially use this information to attempt to gain access to the machine or network. Thereby allowing an authorized or unauthorized user to obtain and misuse critical agency data.

Only necessary and required users should have access to services, particularly those services containing potentially sensitive information such as service names and versions running. Such information could assist an unauthorized user to attack the agency's network.

Recommendation

We recommend KYTC, in coordination with COT, ensure all services on network machines are restricted to only those users with a specific, business related need. Public or anonymous users should not be allowed access. Any new devices placed on the network should be reviewed for open ports and services which may provide default access to public or anonymous users. Unnecessary services should be disabled. For business-related services, authentication should be configured and only users who have a specific business need for the services should be granted access.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-TC-54: The Kentucky Transportation Cabinet In Coordination With The Commonwealth Office Of Technology Did Not Ensure Sufficient Authentication Was Required To Access Potentially Sensitive Information (Continued)**

Management's Response and Corrective Action Plan

The Commonwealth Office of Technology (COT) is in the process of reviewing the detail findings provided by the auditors. Of the 22 machines mentioned in the audit, 20 are maintained by COT. Eight of the machines are in remote locations and cannot be managed over the network. This will require that support staff go onsite to review the configuration. A ticket has been assigned to investigate and secure these 8 machines by closing ports if possible and implementing a strong administrative password. This is expected to be completed by the end of the calendar year. Findings relating to five of the original machines were completely remediated shortly after the scan was performed. In addition, all findings for the seven remaining machines have been remediated in response to the current findings.

While this will address the issues identified in the detail findings directly, COT is currently working towards a long term solution and has initiated a project to develop hardened baselines for new COT managed devices that connect to the Commonwealth network. This project is in the early planning phase and there is not a projected time of completion at this time. The project is expected to continue throughout the coming year.

KYTC investigated the 2 hosts not managed by COT. KYTC worked with the authorized support vendor to resolve the reported vulnerability associated with one of these hosts. KYTC is actively working to harden the remaining host of which will be completed by the end of 9/2012.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 12-TC-55: The Kentucky Transportation Cabinet Did Not Implement Adequate Security Over The Pontis Bridge Management System

Our Fiscal Year (FY) 2012 review of the system controls associated with the Kentucky Transportation Cabinet's (KYTC) Pontis Bridge Management System (Pontis) revealed KYTC allowed the use of group accounts and did not employ sufficient segregation of duties between the system security administration and data processing.

Our review of user accounts with access to Pontis found 10 test user accounts assigned to individual functional roles and designated for use by the three system administrators to troubleshoot problems. Although the need for system administrators' access to these functional areas appears reasonable, the use of a single account by multiple users does not allow for tracking of actions by an individual user. Discussions with the agency revealed there is not a manual or automated log in place to track the use of these accounts.

In addition, our testing revealed one individual was granted access to three different security roles - Contract Inspector, District Inspector, and System Administrator. As a result, this individual can perform system administration tasks such as managing user access in addition to other tasks typically designated for the contract and district inspectors, such as entering and reviewing bridge inspection data. According to KYTC management, this individual is a Chief Bridge Inspector and a National Bridge Inspection Standards (NBIS) Program Manager. Thus, this individual has unlimited access to Pontis including entering and reviewing inspections and management of the use, configuration, functionality, and security of the system.

Failure to apply strong logical security and segregation of duty controls could increase the risk of unauthorized data modification to files and programs, destruction of assets, interruption of services, inappropriate or illegal use of system resources, and the likelihood of errors or losses occurring because of incorrect use of data, programs, and other resources.

Logical security controls should be strong in order to ensure only authorized individuals have access to the system, have appropriate access rights to the functionality of the system based on their job duties, and do not have rights to system functionality that would cause segregation of duty concerns. As an example, a single individual should not be allowed to perform system administration tasks as well as be able to enter, review, and/or approve bridge inspection data. Further, access to the test environment and production servers should be monitored to ensure changes made are appropriate. Smaller organizations that cannot easily segregate duties should implement compensatory controls to supervise and monitor system activities to ensure bridge inspection data is accurately recorded and processed.

Recommendation

We recommend KYTC develop a log in order to track the use of the 10 test user accounts. This log should capture the system administrator's name, the name of the test account being used, the date in which the test account was used, and justification as to why the system administrator had to use the test account. Management should review this log on a regular basis to ensure access to Pontis data appears appropriate.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 12-TC-55: The Kentucky Transportation Cabinet Did Not Implement Adequate Security Over The Pontis Bridge Management System (Continued)**

Recommendation (Continued)

Further, we recommend KYTC review the current job duties of the individual performing the security administration and inspector functions within Pontis and determine how these job functions can be redistributed among staff or access can be potentially restricted to ensure segregation of duties. Specifically, KYTC should ensure the system administrator, who currently has unlimited access to the system, is not allowed to enter, review, or approve inspection data.

Management's Response and Corrective Action Plan

The 10 test accounts referenced in the formal comment are provided by the system. These accounts were not created/customized by KYTC. The accounts are used by 2 Pontis administrators and are required for troubleshooting user access and functionality issues. Each test account corresponds with specific role assignments. The system does not allow for changes to the code to developing a customized method to track which of the 2 administrators are using the test account.

KYTC is aware of the individual that has been assigned to different roles. KYTC management has advised that this is authorized as each role is applicable to his job functions. The individual has been assigned 3 separate accounts and each assigned to the appropriate role. KYTC management has also advised that they will establish documented rules regarding the current segregation of duties; an individual cannot review and approve the inspection to which he/she has performed. Currently the application supports not allowing an individual to review or approve an inspection to which he/she has performs.

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APPENDIX

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2012**

This report is available on our website, www.auditor.ky.gov in PDF format. For other requests, please contact Gregory Giesler, APA's Open Records Administrator, at (502) 564-5841 or gregory.giesler@auditor.ky.gov. If copies of the CAFR for FY 12 are required, please contact Lori H. Flanery, Finance and Administration Cabinet Secretary, at (502) 564-4240 or lori.flanery@ky.gov.

The list includes agencies receiving financial statement audits by Certified Public Accounting firms (CPA) used for preparing the Commonwealth's CAFR. CPA reports are available upon request to the respective agency.

Bluegrass State Skills Corporation
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Turnpike Authority of Kentucky
Room 78, Capitol Annex Building
Frankfort, Kentucky 40601

Kentucky Transportation Cabinet
Kentucky Transportation Cabinet Worker's Compensation
200 Mero Street
Frankfort, Kentucky 40622

Kentucky Center for the Arts
5 Riverfront Plaza
Louisville, Kentucky 40202-2989

Kentucky Economic Development Finance Authority
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Kentucky Housing Corporation
1231 Louisville Road
Frankfort, Kentucky 40601

Kentucky Retirement Systems
Perimeter Park West
1260 Louisville Road
Frankfort, Kentucky 40601

Kentucky Teachers' Retirement System
479 Versailles Road
Frankfort, Kentucky 40601

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)**

University of Louisville
2301 South 3rd Street
108 Grawemeyer Hall
Louisville, Kentucky 40292

Western Kentucky University
Vice President for Finance and Administration
1 Big Red Way
Bowling Green, Kentucky 42101-3576

Murray State University
322 Sparks Hall
Murray, Kentucky 42071

Kentucky State University
Office of Administrative Affairs
400 East Main Street
Frankfort, Kentucky 40601

Kentucky Lottery Corporation
1011 West Main Street
Louisville, Kentucky 40202-2623

Kentucky State Fair Board
Kentucky Fair and Exposition Center
P.O. Box 37130
Louisville, Kentucky 40233-7130

Kentucky Educational Television Authority
600 Cooper Drive
Lexington, Kentucky 40502

Kentucky Higher Education Assistance Authority
1050 U.S. 127 South, Suite 102
Frankfort, Kentucky 40601

Kentucky Higher Education Student Loan Corporation
Financial Services Department
10180 Linn Station Road, Suite C200
Louisville, KY 40223

Kentucky Infrastructure Authority
1024 Capital Center Dr., Suite 340
Frankfort, Kentucky 40601

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)**

Kentucky Local Correctional Facilities Construction Authority
Suite 261 Capitol Annex
Frankfort, Kentucky 40601

Kentucky Judicial Form Retirement System
P.O. Box 791
Frankfort, Kentucky 40602

University of Kentucky
301 Peterson Service Building
Lexington, Kentucky 40506-0005

Eastern Kentucky University
Vice President for Business Affairs
521 Lancaster Avenue
Richmond, Kentucky 40475-3101

Morehead State University
Office of Accounting and Budgetary Control
207 Howell-McDowell Administration Building
Morehead, Kentucky 40351-1689

Northern Kentucky University
Office of Business Affairs
Lucas Administration Center
726 Nunn Drive
Highland Heights, Kentucky 41099-8101

Kentucky Community and Technical College System
300 North Main Street
Versailles, KY 40383

Kentucky Council on Postsecondary Education
1024 Capital Center Drive, Suite 320
Frankfort, Kentucky 40601

Office of the Petroleum Storage Tank
Environmental Assurance Fund
81 C. Michael Davenport Boulevard
Frankfort, KY 40601

Kentucky Public Employees' Deferred Compensation Authority
101 Sea Hero Road, Suite 110
Frankfort, KY 40601-5404

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2012
(Continued)**

Workers' Compensation Program
State Office Building, 3rd Floor
501 High Street
Frankfort, KY 40601

Kentucky Department of Labor - Special Fund
1047 US Highway 127 S, Suite 4
Frankfort, KY 40601

Kentucky Horse Park Foundation
4089 Iron Works Parkway
Lexington, Kentucky 40511

